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***Iraq Targets 2.8Mn B/D Oil Production Level By April 2004 – If Security Prevails***

*MEES Editor Walid Khadduri reports from Baghdad:*

The Iraqi Ministry of Oil has finalized a plan to gradually reach a production level of 2.8mn b/d by April 2004, provided that there is the necessary security, electric power and finance, *MEES* learns from authoritative sources. Iraq had a pre-war capacity of around 3mn b/d and averaged 2.23mn b/d in 2002. Current production is approximately 1mn b/d.

The plan, prepared by an in-house team from the ministry and its affiliated companies, and discussed in a workshop with Team Rio (Restore Iraq Oil) composed of representatives of the US Army Corp of Engineers (USACE), the Coalition Provisional Authority (CPA) and Kellogg Brown & Root (KBR)/Halliburton, was finalized in early July.

**Oil Production And Exports**

The approximately \$1.6bn plan calls for a sustained production capacity of 1.5mn b/d by October 2003, rising to 2mn b/d by December 2003 and 2.8mn b/d by April 2004. Iraq's domestic consumption is approximately 350,000 b/d.

The nine-month plan (July 2003-April 2004) will focus on the repair and rehabilitation of the surface facilities of the upstream sector which received the brunt of the bombing in the war, and the looting and sabotage afterwards. The management of the projects and construction work will be carried out by the Southern Oil Company (SOC) and Northern Oil Company (NOC) and other ministry affiliated firms, particularly the State Company for Oil Projects (SCOP). Procurement and engineering is being carried out initially by KBR and later by the winners of the new tenders already announced by Team Rio and expected to be awarded in the second half of August. The US will fund through KBR over \$1bn, while Iraq will provide approximately ID20bn. The exact division of labor between the ministry, the companies and KBR is not yet clear.

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The principle underpinning the rehabilitation program is that the oil industry is the property of the Ministry of Oil and that SOC and NOC are the owners of the projects. There will be a resident engineer from these companies to supervise the work, submit periodic reports and undertake the necessary tests before accepting project completion. Around five or six projects will be implemented directly by foreign engineering and construction firms because of their highly specialized nature, including: the Fatha crude oil and products pipeline that runs under the Tigris River near Baiji; the metering station on the Iraq-Turkey pipeline near Zakhō; the K3 pumping station at the juncture of the strategic pipeline and the East-West pipeline system; and the Qarmat Ali water processing plant.

The plan also calls for the maximization of the Iraqi component in the projects through the involvement of oil ministry companies, industry ministry firms and the Iraqi private sector. The Iraqi oil authorities will defray the local currency component of the projects. However, the extent of the funds available to them to carry out such work is not yet clear. The accounts of the oil ministry, along with other ministries, have been frozen, and current expenditure (other than salaries) is met from the sale of gasoline and other products domestically. The ministry has asked that its restoration and development budget be financed by allocating a cost of production of approximately \$2/B from the country's output, similar to the request put to the UN under the oil-for-food program.

Meanwhile, approximately \$1.7bn worth of oil equipment and supplies are available to Iraq under the UN oil-for-food program. Of this total, around \$1.2bn worth of contracts were signed by the former Iraqi government and approved by the UN sanctions committee, with the necessary letters of credit opened. However, the Iraqi authorities have been asked by the CPA to prioritize these supplies according to their needs – a factor which is causing a delay. Moreover, around \$500mn worth of equipment has been allocated funds, but the letters of credit have not been opened. These supplies are also being prioritized, causing further delays. Only those contracts signed and approved before 20 March are still valid.

*MEES* understands that the capacity of Iraq's northern and southern fields are as follows:

<b>Northern Fields</b>	<b>B/D</b>	<b>Southern Fields</b>	<b>B/D</b>
Kirkuk	550,000	South Rumaila	800,000
Jambur	100,000	North Rumaila	500,000
Bai Hassan	150,000	West Qurnah	200,000
Ajil (ex-Saddam)	25,000	Zubair	200,000
Khabbaz		Misan/Bazarkan	100,000
Ain Zalah/Batmah	20,000	Lahis	50,000
		Nahr Bin Omar	10,000
		Majnoon	50,000
<b>Total</b>	<b>875,000</b>	<b>Total</b>	<b>1,910,000</b>

Source: *MEES*.

So far, because of the security situation in the country, Iraq's State Oil Marketing Organization (SOMO) has been able to export 8mn barrels of Kirkuk crude stored during the war in Ceyhan and has awarded tenders for 8mn barrels of Basrah Light. Negotiations for selling one more cargo of Basrah Light in early August are under way. SOMO plans to sell crude both to end-users and reputable oil trading companies. "We prefer selling to refiners, but this does not stop us if the price is right to deal with a reputable trading company," a SOMO official told

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*MEES*. "Naturally, we define for them the destination because it is based on the benchmark for that region. We ask them for discharge certificates, the end-users they sold to and the price sold to third parties." Geneva-based Taurus is the only trading firm to be awarded a contract so far. It is also understood that, contrary to some reports, SOMO does not intend to open offices abroad. All sales negotiations are expected to be concluded in Baghdad.

Meanwhile, plans are under way to resume term contracts as soon as possible. These will be for a short duration and will consist mainly of Basrah Light. There are no plans to export Kirkuk crude in the immediate future because of damage inflicted during the war and sabotage and looting since then.

Plans under way for the immediate future envisage the production of around 500,000 b/d of Kirkuk crude to extract the associated gas and supply the Baiji refinery (current throughput of around 180,000 b/d) and the Daura refinery outside Baghdad (70,000 b/d), with the remaining de-gassed crude being re-injected in the field. Production of Basrah Light is expected to be around 800,000 b/d as Halliburton installs pumping facilities at Qarmat Ali water processing plant and security improves. SOC provides 140,000 b/d for the Basrah refinery and 20,000 b/d for the local power station. This means, in effect, that SOMO should have the capacity next month to export around 600,000 b/d on a term basis. The availability of 4mn barrels of storage facilities in the southern fields provides for some flexibility in the southern export system.

*MEES* soundings indicate that the production plan appears optimistic, considering the many bottlenecks and challenges facing Iraq today. Some of the hurdles that Iraq will encounter are security, stability, finance, power shortages, delays to oil-for-food contracts and, last but not least, the continuation of looting and sabotage. New equipment installed by KBR since the war has already been looted.

#### **Expansion Of Production Capacity**

The Ministry of Oil also aims during the fourth quarter of this year to draw up plans to restore the country's pre-1990 production capacity of 3.5mn b/d during the period 2004-05, *MEES* learns. The focus will be to restore the potential of the reservoirs – in contrast to the current nine-month plan to rehabilitate the surface facilities. The work will include drilling, workover, development completion of uncompleted fields and the laying of pipelines.

*MEES* also learns that the plans under discussion are based on the fact that Iraq's pre-Kuwait war (1991) capacity of 3.5mn b/d will remain under the authority of the Ministry of Oil and be operated as part of the national effort. The ministry's affiliated companies will operate and maintain these fields, and perhaps raise their capacity to 4mn b/d. It is expected that service and technical contracts will be signed with specialized firms to assist in the restoration of the lost capacity as well as the enhancement of productivity from currently producing fields.

*MEES* soundings also indicate that new fields in the south, north and east of Baghdad will be developed in cooperation with international oil companies (IOCs), national oil companies (NOCs) and independents to reach a production level of 4-6mn b/d. No decision has been taken yet on the exact formula to be used: production-sharing, development and production agreements, advanced buy-backs, or joint ventures. If the political situation allows and the rehabilitation program takes off, then the ministry envisages starting by end-2003 to draw up a draft policy for future expansion. In any case, such a policy would require the approval of a recognized Iraqi government that would adopt the proposed policy, plus an elected parliament to pass the necessary legislation.

#### **Past Contracts And Agreements**

*MEES* understands that the Ministry of Oil intends to review in the next few weeks the contracts signed by the previous regime with Jordan, Turkey and Syria. The heavily discounted crude and products supply agreements with these neighboring countries are not expected to be renewed. However, it remains to be seen what new commercial accords, if any, might be reached in light of the new political circumstances. Baghdad, with US

approval, is temporarily bartering fuel oil for gasoline and/or LPG with private firms in Kuwait, Jordan and Turkey – but not Syria.

Meanwhile, the state of the upstream contracts that were signed with international and national oil companies during the Saddam era remain in suspense pending the establishment of a recognized government. *MEES* learns that the status of the contracts is as follows:

- **Lukoil:** The Iraqi government annulled last December the development and production agreement with a Russian consortium led by Lukoil and including Zarubzhneft and Machinoimport for West Qurna Phase 2 with a production capacity of around 600,000 b/d. What triggered the cancellation, according to well-informed Iraqi sources, was the statement by Lukoil's chairman that he discussed with US authorities the status of the contract in post-Saddam Iraq. However, Baghdad requested of Moscow that a second Russian consortium do the job; but none formally applied. Since the war, Lukoil has presented a letter to the Ministry of Oil concerning its case but was told that the matter could only be reviewed by a recognized government.

There is much skepticism in Baghdad about the Lukoil agreement, especially since the investment contract was signed during the sanctions regime and in contravention of UN resolutions. Moreover, Lukoil did not meet its obligations during the first exploration period (mid-1997 to mid-2000). While the Russian firm opened an office in Baghdad, held joint management committee meetings and undertook an extensive training program in accordance with the terms of the agreement, Lukoil did not carry out seismic or drilling activities and did not sign a detailed engineering deal it negotiated with an Italian firm. Basically, nothing was done in the field. Whether an amicable agreement can be reached, or the case goes to arbitration, remains to be seen. If it is the latter, then development of one of Iraq's main discovered fields could be delayed for many years.

- **CNPC:** The Chinese signed in mid-1997 a contract for the development of the Ahdab field (capacity 90,000 b/d) under the umbrella of al-Waha company in Dubai. The firm did not carry out any oil exploration and focused instead on trade through the UN oil-for-food program. It is understood that the Chinese contract is even more specific than that of Lukoil concerning what work should have been undertaken under sanctions. Accordingly, the agreement is technically invalid, although the Saddam regime never threatened the Chinese with cancellation of it.
- **Petrovietnam:** The 'Ammara field agreement (80,000 b/d) is still valid. A joint management committee meeting was scheduled for mid-March in Vietnam but was cancelled because of the war in Iraq.
- **Syrian Petroleum Company:** The agreement for the 50,000 b/d Nur field, a service contract for a fee, was signed in May 2001 but was not ratified.
- **ONGC:** The agreement with the state-owned Indian firm for Block 8 in the western desert was ratified at end-2000. The accord calls for the making of a commercial discovery, followed by the negotiation of a production-development agreement with a rate of return of around 18-20%. A senior ONGC delegation visited the Ministry of Oil in early July. ONGC is expected to start exploration once security prevails in the southern part of the country.
- **Pertamina:** The accord with the state-owned Indonesian firm for Block 3 in the western desert was signed in April 2000 and ratified in December 2002. There has been no exploration work yet. It is understood that Pertamina is sounding out other companies for a possible farm-in. The block is estimated to contain 2bn barrels of oil reserves and 1.2 trillion cu ft of gas.

### **Oil In An Uncertain Future**

The Iraqi people today, particularly the residents of Baghdad, live in a state of fear for their lives and property. The period of lawlessness has stretched over three months, taking the form of looting and the burning of public property, a huge number of car thefts, kidnapping for ransom and, lately, armed house robberies. The US, after a quick victory, disbanded the Iraqi army and police (including the oil police) but failed to offer a viable alternative to maintain law and order. The failure stems from lack of well-studied plans, frequent changes of policies and senior civilian personnel, and the inability to decide whether to bear the full responsibility of an occupying power with all the human and material resources that this entails, or transfer the power as soon as possible to the Iraqi people in cooperation with the UN in order to end the occupation.

The absence of viable and authoritative public institutions in Iraq today is compounded by the fact that the country has suffered during the past 23 years from three major wars and 12 years of sanctions. The country's infrastructure has deteriorated and cannot cope with present needs, particularly the national power grid (for an analysis of Iraq's power industry, see *MEES*, 28 April). Machinery in the public sector is, on average, around 20 years old, and the newest equipment is 13 years old. The sustained electricity shortages are creating bottlenecks in all parts of the economy and major problems for the people, especially during the summer when the temperatures in the central and southern parts of the country average around 45-50° C (113-122°F). More and more questions are being raised concerning the CPA's slow handling of such issues. One example is the rehabilitation of the 640mw Daura power plant which is contracted to Siemens, in accordance with the oil-for-food program. But thus far the CPA has refrained from giving Siemens approval to complete the project.

The US, meanwhile, is carrying out its programs in Iraq to: eliminate weapons of mass destruction, combat terrorism, remove all traces of the Saddam regime, eradicate Ba' thists from public life, establish a free economy and a democracy, and normalize relations with Israel. In attempting to do so, the US has abolished the 80-year-old Iraqi state and is trying to build a new one with a social contract, political alliances and civil governance that are different from those in the past. However, Washington is trying to carry out all these policies at once as it encounters increasing armed resistance, especially from Saddamists and Islamists, and as US domestic criticism over the WMD issue – the reason for launching the war – grows.

US President George W Bush has made it clear that his administration is determined to stay the course and carry out its policy to the end in Iraq. This is gradually being interpreted in the region as an indication that the US intends to stay in the country much longer than originally thought. Stories circulating widely in Baghdad speak of the US armed forces refurbishing the four air bases at Nasiriyah, Habaniyah, Balad and Tikrit in preparation for a long stay. At the same time, the permanent five members of the Security Council in New York are discussing the involvement of the UN more directly in the Iraqi administration and in policing efforts. However, the exact formula for this has not yet been hammered out, and a few more weeks may pass before it becomes clear whether or not there will be a more comprehensive and effective UN presence in Iraq.

The Iraqi oil sector was one of the few public institutions in the country that was able to pull itself together very quickly and effectively after the war. As early as 13 April, less than a week after the fall of Baghdad, the oil ministry began functioning – albeit in very difficult circumstances: without a government, authority, security or budget, and under occupation. The Ministry of Oil team gradually made contacts with the affiliated companies in the north and in the south, despite the absence of telecommunications, in order to meet domestic products demand and to protect the oil industry from further looting and theft. Today, the country has enough supplies and is planning to resume exports gradually.

However, there are many problems ahead. The looting of public property continues. Smugglers puncture pipelines and storage facilities in order to ship products to the lower Gulf. The sabotaging of crude, gas and products pipelines continues unabated with two aims in mind: to hinder exports (as is the case with Kirkuk crude), or disrupt supplies to refineries to create shortages and public discontent. The Ministry of Oil is short of money; the only funds available to it today are salaries provided by the Treasury and what cash it can collect

from selling domestic products – hardly enough to survive on and meet many of the grave challenges that it encounters daily.

Finally, there is still no minister. Thamir Ghadhban, the former director general for studies and planning, assumed a leadership role on 13 April and has been the Ministry of Oil CEO since then, having won the confidence of his colleagues and associates for assuming the necessary authority in the trying post-war days. Mr Ghadhban is the leading candidate being considered by the Iraqi Governing Council for the post of interim minister of oil.

The problem that has plagued the Iraqi oil industry and curtailed its growth during the past 40 years in a way that was commensurate with the country's huge hydrocarbon reserves has been the volatile politics of the state. Now, Iraq is at a crossroads once more. The danger today is that if the political situation deteriorates – and this is a real threat – then the oil industry will not only be unable to expand but could also fail to return to its previous capacity. The development of the oil industry, and the economy as a whole, cannot start in earnest unless there is security, stability and a credible authority. Iraq has a long way to go before reaching that stage – and the road ahead is difficult.

## **SAUDI ARABIA**

### **IOCs To Bid For Three Gas Blocks In Former CV 1 Package**

The Saudi Ministry of Oil, in a meeting in London on 22-23 July with the representatives of 41 international oil companies (IOCs), gave details of 120,000 sq km of acreage, divided into three contract areas, that will be open to bids for natural gas exploration and production (E&P). The areas in question were originally included in the package associated with the Core Venture 1 (CV 1) under the Saudi Natural Gas Initiative. CVs 1 and 2 were scrapped after the failure of talks between the IOCs and the Saudi government, while Shell and Total have formed a joint venture with Saudi Aramco to carry out gas exploration in Blocks 5-9 and 82-85, the area that had been assigned to CV3 (*MEES*, 21 July).

The London meetings, which took the form of extended briefings, represented the first step in a preparatory process leading to the award of contracts. IOCs received information on the economy of Saudi Arabia, the gas industry and demand, geology, fiscal and legal systems, and the bidding process. The second step will be for those IOCs that continue to express interest to visit the kingdom. At this point they will have a chance to study in detail the Saudi Aramco data base. The third stage will see the offer/bidding process begin.

In remarks at the opening of the London meetings, Oil Minister Ali Naimi spoke of Saudi Arabia's goal of attracting international investment as part of its economic reform program. He said that "a significant aspect" of the program was the opening of the upstream gas sector to foreign investment. "The tracts being offered in this round," Mr Naimi continued, "represent the first phase of the upstream offering program, with more acreage to follow in the future. Clearly, the upstream gas opening is a strategic decision by the government in support of economic liberalization, and will help attract direct investment. However, the true importance of this gas offering is best appreciated when seen in the wider context of the kingdom's Seventh Development Plan."

Economic development efforts in this plan, the minister said, focused on the diversification of national revenue sources, the expansion of the production base, and the creation of more jobs for Saudi citizens. It also set aggressive targets for the five-year period ending in 2004. Private sector annual growth was expected to exceed 5%, while foreign investment was anticipated to grow at almost 7% a year.

"More specific annual growth targets should be of particular interest to prospective gas investors," Mr Naimi said. "The industrial sector is set to grow in excess of 5% per year; electricity and water demand at 4.5% and 5.5% respectively; petrochemicals and other downstream industries at more than 8%; and the energy-intensive mining sector is forecast to grow more than 9% annually. These growth targets, which are expected to continue into the future, are indicative of strong growth in gas demand. In fact, the latest Kingdom Gas Strategy forecasts

domestic gas demand to exceed 12bn cu ft/day by 2025. With demand for gas rising rapidly, and an extensive gas infrastructure already available in the form of the Master Gas System (MGS), the stage is set to economically expand the supplies of natural gas.”

### Regulatory Procedure

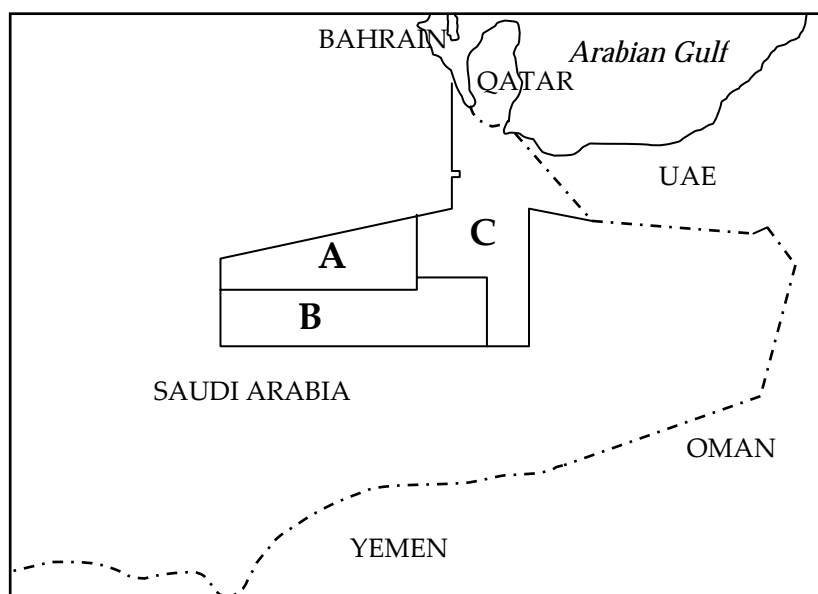
Turning to the terms governing natural gas E&P investments, Mr Naimi stressed that the Saudi government “recognizes the importance of providing transparent and predictable regulations, as well as a competitive fiscal regime. The combination of the two will enable foreign companies to make substantial investments with confidence. For this reason, the country has created well-conceived and well-balanced regulatory, fiscal and legal regimes which we believe will produce a win-win situation for the kingdom and for investors.”

In conclusion, the Saudi minister said his government believed “the terms of this offer are fully competitive with other E&P investments available around the world. This offering also presents an historic opportunity for your companies to establish a long-term partnership with the Kingdom of Saudi Arabia.”

In response to questions from reporters, Mr Naimi said the aim was for a complete package, including a draft contract and details of the fiscal regime, to be sent to the interested IOCs by mid-September – with the possibility of conclusion being achieved in 1Q 2004. “The original package was much more complex,” he continued. “It was obvious there must be a different way of doing business, and that is why we have switched to separate the projects.” While IOCs would not be allowed to recover any oil that might be discovered, it would be paid export prices for other liquids. All the gas discovered would be for domestic consumption, with Saudi Aramco guaranteeing offtake.

### Offering Objective

In their briefings, the IOCs at the London meetings were told that the objective of the offering to them was to continue maximizing the economic and social benefits to the kingdom from its natural gas resources. This would be achieved by “undertaking aggressive exploration programs of under-explored areas of the kingdom to discover large additional resources of gas that can be economically developed to expand supplies...[and by] expanding gas supplies to major industrial centers in the kingdom to drive further rapid industrialization and job creation.” The aim was also to create long-term partnerships with qualified world-class energy companies and to attract foreign direct investment.



The 120,000 sq km of offered acreage is located in the North Rub'i al-Khali Basin, south of the Ghawar field and facilities – an area, the IOCs were told, which is “highly prospective for gas and condensate, with numerous leads and prospects identified.”

<b>Contract Area</b>	<b>Sq Km (Approx)</b>
Area A	29,900
Area B	38,800
Area C	51,400

In assessing the Minimum Work Program, the IOCs were told that exploration wells and seismic were the key bid parameters.

#### **Minimum Work Program (Floor)**

	<b>Area A</b>	<b>Area B</b>	<b>Area C</b>
<b>1<sup>st</sup> Exploration Period</b>			
Duration (Years)	5	5	5
No Of Exploration Wells	2	2	2
Km 2D Seismic	4,000	3,000	3,000
Remaining Contract Area After Relinquishment	50%	50%	50%
<b>2<sup>nd</sup> Exploration Period</b>			
Duration (Years)	3	3	3
No Of Exploration Wells	2	2	2
Km 2D Seismic	2,000	2,000	2,000
	50%	50%	50%
<b>3<sup>rd</sup> Exploration Period</b>			
Duration (Years)	2	2	2
No Of Exploration Wells	2	2	2
Km 2D Seismic	None	None	None

A 10-year Exploration phase would be divided into three periods, with the second and third optional. There would be a 25-years production term per Contract Area, with a maximum term of 40 years. There would be no signature bonus or rental fees.

The reservoir classification in the Gas Offering will be based on “a pre-determined threshold volume of crude oil below which a reservoir will be classified as a non-associated gas reservoir...[and] finality of reservoir classification after appraisal...[A] compensation mechanism is provided for certain appraisal costs if a reservoir is classified as other than non-associated gas reservoir and development is denied.”

#### **Commercial Terms**

The IOCs were told that the Saudi government would fund the construction of a gas pipeline from the MGS to the Contract Area delivery point, subject to a minimum aggregate volume of 350mn cfd. There would be three disposition options:

- Offtake by Saudi Aramco. Subject to a minimum aggregate volume of 350mn cfd, Saudi Aramco would offtake sales-quality gas at the delivery point through a firm take-or-pay agreement.
- Sale to End Facilities. Subject to applicable regulations, companies may sell production to end-use facilities (including those owned and operated by the companies or their affiliates).
- Sale to 3<sup>rd</sup> Party Facilities. Through independent systems.

Recovery of NGL and condensate. The companies may construct facilities to recover and deliver raw NGLs and condensate to the Saudi Aramco systems at mutually agreed delivery points. Saudi Aramco will purchase these liquids through a take-or-pay agreement.

Saudi Aramco will participate in the upstream gas company with a 20% working interest on a “heads-up” basis.

Production Pricing. Natural gas will be priced at the government established price (currently \$0.75/Mn BTU) less the MGS tariff established by the Ministry. A contractual guaranteed minimum price of \$0.60/mn BTU will apply for the duration of the contract. NGLs will be priced on an individual component basis for propane, butane and natural gasoline – at export prices (FOB Ras Tanura) less regulated tariffs for transportation, fractionation, storage, terminal and marketing fees. Ethane will be priced at the kingdom’s established price, minus the MGS tariff. Condensate will be priced at the international price, less handling and marketing fees.

### **Fiscal Terms**

Natural gas investment activities are subject to the Natural Gas Investment Tax (NGIT): flat 30% tax rate until investors’ return achieves 8% IRR; increases to 85% when IRR reaches 20%.

Additional fiscal incentives include: 50% uplift on eligible capital expenditure for depreciation purposes; no royalty for extracted NGLs and natural gas; pay on behalf (sic) until investor achieves a 12% IRR (with flat 30% tax); and 20% condensate royalty – investor flexibility to bid on cumulative condensate production to be exempted from royalty.

### **The Way Ahead**

IOCs must confirm their interest in participating in the Initial Upstream Gas Offering by 31 August, and their desire to access Saudi Aramco’s Upstream Data Room by 15 September. They then have to facilitate a Q&A on the bid package and contracts by 30 October. Companies will be notified of any potential modifications to the bid package by 30 November. The deadline for the signature of the Upstream Agreement has been set for 1 March 2004.

### **SABIC European HQ Moves To The Netherlands**

Saudi Basic Industries Corporation (SABIC) announced on 14 July that its European headquarters (SABIC Global) was in the process of moving from London to Sittard in the Netherlands, the base of SABIC EuroPetrochemicals. The new headquarters will be the platform for all of SABIC’s chemicals and polymers business in Europe. The transfer began in July and will be completed by end-2003. SABIC said that “a significant number of SABIC Global employees directly associated with the sales and marketing of SABIC products in Europe will relocate to Sittard in the coming months. Several SABIC Global employees will remain in the London offices until March 2004.” SABIC EuroPetrochemicals, with a workforce of around 2,300, owns two petrochemical sites – one in Geleen, in the Netherlands, and the other in Gelsenkirchen in Germany.

## **KUWAIT**

### **KPC To Formally Accept Consortia Bidding For Project Kuwait By End-August**

MEES learns that Kuwait Petroleum Corporation (KPC) within the month of August will formally accept the composition of consortia bidding for contracts to develop and expand output from the producing oilfields in the north of the country (Project Kuwait). Thereafter, the consortia will be required to submit development plans, ahead of the bidding and selection process. Three consortia have been formed:

- ChevronTexaco (leader, 50% stake), with Total (20%), PetroCanada (10%), Sibneft of Russia (10%) and Sinopec (10%).
- BP (leader, 65%), with Occidental (25%), and ONGC/Indian Oil Corporation (10%).
- ExxonMobil (leader, 37.5%), Shell (32.5%), PhillipsConoco (20%), and Maersk (10%).

The only shortlisted potential operator that does not appear in the above consortia is Eni, and *MEES* learns that the Italian firm has decided not to proceed with the project. Marathon, Encana and OAO Siberian Oil Company are shortlisted non-operators that have not joined a consortium (*MEES*, 7 July). All the shortlisted companies attended a meeting with KPC in London on 15/16 July to discuss fiscal terms and other issues related to Project Kuwait. The country's plans for opening up its upstream oil sector to investment from IOCs – originally launched in 1998 – envisage the expansion of output from a number of oilfields in the northern and western parts of the country to the tune of some 900,000 b/d within a time span of around five years from the date of operations starting.

KPC is going ahead on the understanding that Project Kuwait is a service-type agreement and therefore not subject to any law governing conventional upstream development which would require approval by the National Assembly. Whether the newly elected parliament agrees with this interpretation will become clear when it sits for the first time in October. According to Kuwaiti press reports on 23 July, Energy Minister Shaikh Ahmad Fahd al-Ahmad is scheduled to meet members of the National Assembly's Finance Committee this week to discuss the issue. *MEES* soundings indicate that some, if not the majority, of deputies will continue to insist that any agreement with an international consortium for the development of the country's oilfields should be presented to the National Assembly as a law. Some parliamentarians see the issue as one related more to the prerogative of the assembly than the question of Project Kuwait *per se*. And even if only a small bloc of deputies stands firm on this issue, the new government could face difficulties, as the previous one did, in proceeding with its plans.

### **Small Fire At Shu'aiba Refinery Disrupts Production**

An oil leak at Mina Shu'aiba refinery on 18 July resulted in a small fire at the facility, *KUNA* reported on 19 July. A Kuwait National Petroleum Company (KNPC) official said that "the necessary procedures had been taken, including a decrease in output in the unit." He did not specify the extent of the output disruption, but added that production would be returning to full capacity (196,000 b/d) on 21 July. No-one was injured in the incident. In February, the crude distillation unit (CDU) at the Shu'aiba refinery was closed for four days after the discovery of an oil leak (*MEES*, 3 March).

## **OPEC**

### **OPEC Unlikely To Change Output Quotas**

The fall in oil prices over the last week has seen the OPEC basket price fall back to within the organization's preferred \$22-28/B price band and as a consequence, OPEC ministers are now thought unlikely to feel any pressure to change production targets at their upcoming extraordinary meeting in Vienna on 31 July. After ten weeks of gently rising oil prices, this week's market readjustment comes at just the right time for OPEC ministers but may prove temporary since the fundamentals that have supported firmer oil prices remain largely in place. These include the slower-than-expected return of Iraqi crude to the market, stubbornly low US oil stocks and ongoing concerns about potential fresh threats to production in Venezuela and Nigeria.

As ministers prepare for the latest in a series of their ever-more-frequent meetings, they will consider that while Iraqi oil production plans remain captive to endemic security problems in the country, there is the first glimmer of light at the end of the tunnel. Since the Doha meeting in early June, the reality of production and transport problems in Iraq has become more clear, demonstrating the mountain that Iraqi oil managers are facing as they attempt to restore production to pre-war levels. However, the decision by Iraq's State Oil Marketing Organization (SOMO) to move to term contracts and away from spot tenders, combined with long-term production forecasts obtained from the oil ministry by *MEES* show that Iraq is moving, albeit at a slower pace than expected, towards sustained production and exports.

While Iraqi representation at OPEC meetings appears unlikely until September at the earliest amid the absence of a recognized government in Baghdad, prospects for at least some certainty on Iraqi production will help

ministers take a view on the supply-demand balance heading into the final quarter of the year. Aside from Iraq, ministers will also be able to consider supply threats to Venezuela, where production fell in June and the oil installations have suffered a spate of sabotage in recent weeks, and Nigeria, where the threat of continued civil unrest continues to cast a shadow over the country's efforts to resume oil production at the levels seen in January and February.

Price gains across the oil complex in recent weeks have been underpinned by strength in the gasoline market and persistent concerns that inventories remain below seasonal averages. This week's US inventory data showed continued falls in crude stocks and the overall tone was supportive for crude and gasoline. The American Petroleum Institute reported a 655,000 barrel decline in crude stocks, a 1.103mn barrel fall in gasoline stocks and a 372,000 barrel build in distillate inventories. Data from the Department of Energy meanwhile was more supportive, showing a 2.3mn barrel fall in crude, a 1.6mn barrel decline in gasoline and a 500,000 barrel build in distillate stocks. JP Morgan's Paul Horsnell noted that the gap between the five-year average for total US oil inventories and present levels had topped out this week. "The key point about this week's US data is that the deficit in total oil inventories from the five year average is not getting any better. Indeed, it has widened by 5.2mn barrels to now stand at 106.5mn barrels, the largest gap of this year," he said in his *Weekly Oil Data Report* of 23 July. He observed that falling refinery utilization rates also were problematic given "yawning oil product deficits".

OPEC's recent revision upwards of 2003 oil demand growth is also likely to underpin prices at the top end of the price band for the time being. In its July *Monthly Oil Market Report* issued on 18 July, OPEC revised its world demand forecast for 2003 by 340,000 b/d to an average 77.79mn b/d compared with the 77.45mn b/d reported in the June report, meaning that 2003 oil demand growth is now expected to come in at 1.01mn b/d – representing annualized demand growth of 1.32%. "This is due to substantial upward revisions in the 2001 and 2002 historical data, as well as revisions of 180,000 b/d and 250,000 b/d in the 1Q03 apparent consumption for FSU and China respectively," the report said. OPEC revised 2001 oil demand higher by 170,000 b/d to 76.54mn b/d and 2002 demand higher by 230,000 b/d to 76.78mn b/d. OPEC said consumption was forecast to grow in every single quarter of 2003 compared with the corresponding quarters of 2002 with the first and the fourth quarters expected to experience the highest growth of 2.33mn b/d and 750,000 b/d respectively.

#### Settlement Prices For Benchmark Crudes (\$/B)

Date	Aug*/Sep WTI	Sep Brent	OPEC Basket
18 July	31.96*	28.93	28.23
21 July	31.78*	28.69	27.98
22 July	30.19*	27.49	27.17
23 July	29.67	27.78	27.00
24 July	30.22	28.16	27.23

### **SUPPLY/DEMAND**

#### **ABN Amro Raises 2004 Oil Price Forecast But Sees Weakness From 2005**

ABN Amro has raised its oil price projection to \$23/B for Brent in 2004, up from \$19/B based on projections of global demand growth of 1.8% and continued success in OPEC's defense of its preferred \$22-28/B price band. In its 3 July report, *Oil Macro 2003 And Beyond*, ABN Amro said it expected to see an average Brent price of \$25.50/B for the remainder of 2003 based on a slow recovery of Iraqi oil production and continued supply risks in Venezuela and Nigeria. "For 2005 and beyond, we assume oil prices revert to the longer-term historical average of \$19/B Brent (\$20.50/B WTI). Although capacity increases we see a mismatch between the growth in the call on OPEC (0.3mn b/d) and OPEC capacity expansion plans (1.0-1.4mn b/d). To balance the market, OPEC will be forced to operate at lower utilization rates and quota allocation will come to the fore," the report said.

The report noted that the lack of Iraqi volume in the market coupled with thin global inventories and supply reassurances from OPEC had kept prices robust in 2Q. "Going forward, we believe Iraqi volume will continue to be subdued given the ongoing security risks and poor infrastructure. This should allow OPEC-10 to continue producing at comfortable levels through the rest of the year, although it will need to continue to monitor Iraqi levels and adjust accordingly," the report said.

ABN Amro said that 2004 global oil demand growth of 1.8% (1.4mn b/d) and 1.3mmb/d of non-OPEC supply growth would keep the call on OPEC crude relatively flat. "We expect Iraqi volume to build next year but believe OPEC-10 (in particular Saudi Arabia) will continue to hunt price rather than volume, and adjust output accordingly to keep prices within the targeted range of \$22-28/B," the report said. But beyond 2004, ABN Amro questions whether OPEC will continue to get squeezed on market share by non-OPEC supply growth and if so, whether OPEC is willing to trade market share for price as it has done in the past couple of years.

"On balance we feel that without strong demand growth, both non-OPEC supply growth and internal capacity additions will put increasing pressure on OPEC. On our current projections it appears that 2005-07 will prove OPEC's biggest test and utilization rates may well fall to 64% compared with 79% in 2003," the report cautioned. However, it said that there were longer-term scenarios under which demand growth is higher, the fall in mature North Sea production steeper and FSU export capacity gains slower. Under these conditions the longer-term outlook for OPEC is brighter with higher utilization rates. ABN Amro said that as is the case with 2003 and 2004, OPEC's longer-term policy may hinge on Iraqi volume. "If the more aggressive target of reaching 6mn b/d by 2010 is realized by Iraq, OPEC will be forced to adjust quotas sooner rather than later and this in itself may be a catalyst for change," it said.

### Japanese Power Generation To Rely Less On Fossil Fuels, Says FACTS

Japan's electricity generation sector will rely increasingly on nuclear power at the expense of fossil fuel burning thermal plants, according to Honolulu's FACTS Inc. In the report *Japan's Long-Term Plans for Power Generation*, published in early July, FACTS analyst Tomoko Hosoe writes that Japan's reliance on nuclear capacity will rise to 41.4% of total power generation in financial year (FY) 2010, from 34.6% in 2001: "Despite a series of problems and accidents involving nuclear reactors, the core of Japan's energy policy will continue to rely on nuclear power, in an effort to achieve targets set under the Kyoto Protocol and create an 'ideal' fuel mix for energy security/diversity."

During April 2002-March 2003, Japan's reliance on nuclear power dropped to 31.4% from 34.6% a year before, says the report, due to a series of reactor shutdowns by Tokyo Electric Power Company (Tepco), Chubu Electric Power Company, and Tohoku Electric Power Company. The report says: "Under METI's (Ministry of Economy, Trade and Industry's) economic outlook, Japan's electricity demand is forecast to reach 946 terawatt-hours (TWh) in FY2010, compared to 824 TWh in FY2001. Thus, an average annual growth rate for the FY2001-12 period is 1.3%, down from a 1.4% average annual growth rate that METI had forecast a year ago under the FY2002 Supply Plan."

**Table 1**  
**Japan's Long-Term Plans For Power Generation**

	FY2001 (Actual)	FY2002 (Preliminary)	FY2010 (Planned)
Nuclear	34.6%	31.4%	41.4%
Thermal	55.6%	59.0%	48.8%
- Coal	20.5%	21.8%	18.9%
- LNG	26.8%	26.9%	23.0%
- Oil/Fuel Oil	6.4%	8.3%	5.1%
- Others*	1.9%	2.0%	1.9%
Hydro	9.5%	9.2%	9.2%
New Energy	0.3%	0.4%	0.5%

\* Including LPG, Orimulsion and geothermal.

Source: FACTS based on METI's FY2003 plan.

The report observes that METI's plans for new thermal power plants, with the exception of hydro-power projects, were revised downwards from one year ago in the face of a bleak demand outlook: "Japan's oil industry association has raised concerns about the government's ambitious plan to increase the use of more environmentally friendly energy sources in Japan's primary energy mix. Their concern is that the current plan is reducing the consumption of oil too drastically, one result of which is the current nuclear crisis in Tokyo. Tepco will face a supply shortage against its forecast peak summer demand, unless more nuclear plants can resume operation. Tepco's reliance on nuclear power generation is about 38% under normal conditions, and now 16 of their total 17 nuclear units remain shut."

**Table 2**  
**Revised Plans For New Thermal And Hydro Plants By End-FY2010**

	Revised Plans (MW)	Previous Plans (MW)
LNG	7,980	8,520
Coal	9,840	13,840
Oil/Fuel Oil	1,910	2,000
Hydro	2,740	2,740

Source: FACTS.

## **OIL PRICES**

### **SOMO Awards Term Contracts For Basrah Light, Sets August Prices**

Iraq's State Oil Marketing Organization (SOMO) announced on 23 July that it had awarded term contracts for the period 1 August – 31 December to several oil majors including BP, ChevronTexaco, ConocoPhillips and Shell following on from its 22 July announcement that it was in talks to tie up term deals for the sale of Basrah Light crude oil from the Mina al-Bakr terminal. Further term contracts with additional lifters are under discussion. Separately, SOMO announced that it had awarded three late July loading cargoes of Basrah Light under an earlier tender to ChevronTexaco, Petrobras and Vitol.

In its 22 July announcement, SOMO announced August official selling prices (OSPs) and the formulas that would be used to set OSPs in the future. August loading Basrah Light to the US was set at second month WTI minus \$4.95/B; to Europe was set at Dated Brent minus \$2.90/B and to the Far East was set at flat to the mean of Oman/Dubai quotes. SOMO said OSPs for each month would be announced in the first ten days of the preceding month and that Basrah Light prices would be reduced by \$0.01/B for each 0.1° below 34° API and increased by every 0.1° above 34° API.

*Following is the full text of the 22 July announcement:*

1. SOMO is negotiating with refiners to enter into long term contracts (1 August up to 31 December 2003) for the sale of Basrah Light crude oil ex al-Bakr terminal.
2. SOMO's official selling prices (OSPs) for Basrah light crude oil ex-al-Bakr during August are as follows:

#### 2-1 FOR THE US MARKET

Basrah Light ex al-Bakr = WTI (second month) - \$4.95/B. The WTI (second month) is calculated by taking the arithmetic average of the means of high and low spot assessments of WTI (second month) quotations as published in the Platts crude oil marketwire for five consecutive quotations starting from the 15<sup>th</sup> day from the bill of lading date (bill of lading date shall be Day 1).

#### 2-2 FOR THE EUROPEAN MARKET

Basrah Light ex al-Bakr = Brent (Dated) - \$2.90/B. The Brent (Dated) is calculated by taking the arithmetic average of the means of high and low spot assessments of Brent (Dated) quotations as published in the Platts

crude oil marketwire for five consecutive quotations starting from the 15th day from the bill of lading date (Bill of lading date shall be Day 1).

### 2-3 FOR THE FAR EAST MARKET

Basrah Light ex al-Bakr = Oman+Dubai/2 flat

The Oman and Dubai are calculated by taking the monthly arithmetic average of the means of high and low spot assessments of Oman and Dubai quotations as published in the Platts crude oil marketwire during the calendar month of loading.

The resulting Basrah Light price is to be reduced by \$0.01/B for each whole one tenth of a degree API below 34 degrees and to be increased by \$0.01/B for each whole one-tenth of a degree API above 34 degrees.

3. SOMO shall announce its official selling prices for each month during the first decade of the preceding month.

Mohammed Al-Jibouri

General Manager

(SOMO)

### Crude Oil Formulas/Posted Prices (\$/B)

**Algeria** (Dated Brent + / - Adjustment Factor; \$/B)

	2003								2002				
	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug
Saharan Blend (44°)	-0.35	0.00	0.00	+0.30	+0.55	+0.35	+0.80	+0.55	+0.17	+0.26	-0.06	+0.20	+0.09

**Yemen** (Dated Brent + / - Adjustment Factor; \$/B)

	2003								2002				
	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug
Marib Light (40°)	-0.60	NA	-0.35	-0.40	-0.40	-0.40	-0.30	-0.30	-0.30	NA	NA	0.00*	*
Masila (30°)	-0.70	-0.44	-0.47	-0.75	-1.05	-0.85	-0.55	-0.57	-0.58	-0.82	-0.56	-0.23	+0.05

\* No exports of Marib Light during July, August or September. Marib Light for September priced at parity with Dated Brent for settlement of accounts with the Aden refinery. The government equity of Marib Light and Jannah crudes was consumed domestically during the July-December 2002 period.

## JORDAN

### Jordan Oil Aid Agreement Renewed Until 20 September

Saudi Arabia and Kuwait have agreed to continue supplying Jordan with crude oil under an economic aid package agreed in March, *MEES* learns (*MEES*, 31 March). Saudi Arabia has agreed to continue supplying Jordan with 50,000 b/d of Arab Light crude, while Kuwait will continue to supply 25,000 b/d of oil until 20 September. The aid package has been renewed on the same terms and conditions as the original agreement, which means that Jordan receives the oil for free. Jordan has relied upon Iraq since the 1991 Gulf War for the supply of some 110,000 b/d of crude oil and petroleum products. The US/UK invasion of Iraq brought a halt to overland deliveries, forcing Jordan to look elsewhere to source its oil requirement.

### Jordan PM Reshuffles Cabinet After Parliamentary Elections

Jordanian Prime Minister 'Ali Abu al-Raghib formed a new cabinet following parliamentary elections on 17 June leaving key members of the former government's economic management in place as well as Energy and Mineral Resources Minister Muhammad Batayneh. Five ministers left the cabinet and eight were brought in with the most significant change being the replacement of interior minister Qaftan al-Majali by Samir Habashneh. Mr Majali had been accused by the resurgent Islamic Action Front of presiding over irregularities in the June

elections. In the economic team, Finance Minister Michel Marto and Planning Minister Basim 'Awad Allah retained their posts, while Muhammad Halaiqa, who was in charge of Jordan's negotiations with the WTO two years ago, was appointed Deputy Prime Minister for Economic Affairs and Minister of Administrative Development. Former secretary general at the Finance Ministry Muhammad Abu Hammur took the Trade and Industry portfolio from Salah Bashir. Hisham Gharaibeh was appointed as the country's first Environment Minister. Former National Economy Minister Samir Tawil was made Minister of Tourism and Antiquities – a portfolio that he took over from Nadir Dhahabi, who is now Transport Minister.

## **IRAQ**

### **US Abandons Idea Of Oil Advisory Board**

*MEES* learns that the US-led Coalition Provisional Authority (CPA) has abandoned the idea of an oil advisory board for Iraq and opted instead to have Philip Carroll, the chairman of the board, to act as senior adviser to the CPA on the Iraqi oil sector. Mr Carroll will also continue functioning as the interlocutor between the CPA and the Ministry of Oil. Mr Carroll has been in Iraq for over two months and has been coordinating relations between the Iraqi oil establishment and the various US public and private institutions in the country.

The board was chaired by Mr Carroll (former Chairman and CEO of Shell Oil Company, US) with Fadhil Othman (former Acting Executive Director of SOMO) as Deputy Chairman, and Thamir Ghadhban, CEO of the Ministry of Oil. Several other Iraqi and international candidates were nominated to the board but they were not confirmed. There were constant consultations among the three board members but no formal meetings.

Senior executives in the Iraqi oil establishment, in addition to Mr Ghadhban, include the following director generals at the ministry and affiliated companies: Radhwan al-Sa'adi, Economy & Finance Dept; Falih al-Khayat, Technical Dept; 'Ali Hammadi, Reservoir & Fields Development; Qahtan al-'Anbaki, Dept of Manufacturing; Muhammad al-Jibury, SOMO; Jabbar al-La'ibi, Southern Oil Company; 'Adil Qazzaz, Northern Oil Company; Husam Kashmula, SCOP; Zuhair Shakir, Iraq Drilling Company; Salim Rizzuqi, Oil Exploration Company; Jabbar al-Waqa', LPG Bottling Company; Riyadh al-Qassab, Baiji Refinery; Dathar al-Khashab, Daura Refinery; Thair Ibrahim, Basra Refinery; 'Abd al-Karim Jasim, South Gas; Samir Michail, Products Distribution; Falah al-'Isa, Iraqi Tankers; and, Salah Karim, Pipeline Company.

## **OMAN**

### **Government To Sell 65% Of New Power Transmission Company**

The Oman government plans to sell initially 65% of the shares in the power Transmission and Distribution Company (Transco) that is under formation to the private sector, an official said on 10 July. In time, Transco will be fully owned by the private sector as part of a process that will see the whole electricity generation/transmission/distribution industry taken out of government hands. The official said the restructuring process would involve investment of \$2.1bn over the next two years. So far, two private power plants are operating in Oman: al-Manah and al-Kamil. Two more projects (Barqa and Salalah) are under construction (*MEES*, 28 May 2001).

## **UAE**

### **Fitchner Wins PMC Contract For Second Fujairah Power/Water Project**

The Union Water and Electricity Company (UWEC) announced on 20 July that it had awarded the project management consultancy (PMC) contract for its second power/desalination project at Qidfa in Fujairah to Germany's Fitchner. PB Power and Mott McDonald of the UK, and Germany's Lahmeyer International, also bid for the contract (*MEES*, 24 March). Fitchner will shortlist contractors for a turnkey engineering, procurement and construction (EPC) contract – to be awarded in mid-2004. The second power plant, to be built close to the first, will have capacity to produce 1,000mw of power and 100mn gallons/day of clean water. Completion is scheduled for mid-2006. The current facility's capacity is 656mw and 100mn g/d. Power production began in late

February, and water in late April. UWEC plans ultimately to privatize both plants, as is happening with power/water projects in Abu Dhabi.

### **ENOC Orders Four Products Tankers From Hyundai**

Emirates National Oil Company (ENOC) announced on 16 July that it had ordered four double-hull petroleum products tankers from Hyundai Heavy Industries for a total of \$140mn. Two orders were placed in June and two in July. Delivery of the four vessels, each with 75,000 ton capacity, is scheduled for 2005. ENOC Chief Executive Husain Sultan said that the products tankers would be "state-of-the-art. They will be fitted with the latest deep-well pumps and meet international environment safety requirements of being completely double-hulled."

## **IRAN**

### **Iranian Crude Exports Average 2.346 Mn B/D For 1H 2003**

According to data from *MEES* sources, Iranian crude exports averaged 2.346mn b/d during the first half of 2003. This compares with an annual average of 2.007mn b/d for 2002 (*MEES*, 17 March). In May 2003, Iran made one shipment of offshore Bahregan crude. The following table gives a monthly breakdown of Iranian crude exports for the first half of 2003, along with quarterly and first half averages:

#### **Iranian Crude Exports January-June 2003**

('000 b/d)

	2003								
	Jan	Feb	Mar	1Q	Apr	May	Jun	2Q	1H
<b>Onshore Fields (ex-Kharg)</b>									
Iranian Light	805	928	947	892	842	662	894	798	846
Iranian Heavy	872	964	818	882	839	797	1,133	922	903
<b>Total Onshore Fields</b>	<b>1,677</b>	<b>1,892</b>	<b>1,765</b>	<b>1,774</b>	<b>1,681</b>	<b>1,459</b>	<b>2,027</b>	<b>1,720</b>	<b>1,749</b>
<b>Offshore Fields</b>									
Foroozan	325	327	311	321	321	275	301	298	310
Lavan Blend	65	102	67	77	98	110	169	125	102
Sirri	107	116	105	109	109	135	111	119	114
Soroush	89	85	27	66	33	99	64	65	66
Bahregan*	0	0	0	0	0	29	0	10	5
<b>Total Offshore Fields</b>	<b>586</b>	<b>630</b>	<b>510</b>	<b>573</b>	<b>561</b>	<b>648</b>	<b>645</b>	<b>617</b>	<b>597</b>
<b>Total</b>	<b>2,263</b>	<b>2,522</b>	<b>2,275</b>	<b>2,347</b>	<b>2,242</b>	<b>2,107</b>	<b>2,672</b>	<b>2,337</b>	<b>2,346</b>

\*Exports of Bahregan crude began in May 2003.

## **ISRAEL**

### **IEC Starts Talks With Yam Thetis On Additional Gas Sales**

State-owned Israel Electric Corporation (IEC) announced on 17 July it had started negotiations with Yam Thetis, the company developing the offshore Mari gas field, for additional quantities of gas over and above existing volumes it has contracted to supply the state utility. Yam Thetis signed a sales agreement in June 2002 to supply IEC's 1,200mw Eshkol power station at Ashdod with 157mn cf/d of gas for 11 years – equivalent to 18 bcm of gas over the entire period – representing some 45% of IEC's requirement for gas in the first stage of the switch to gas (*MEES*, 1 July 2002). Delivery was scheduled to start in 3Q but is now expected to start in early 2004, due to delays in the construction of pipeline infrastructure needed to land the gas at Ashdod (*MEES*, 9 June). According to an IEC statement, any additional supplies agreed with Yam Thetis will bridge the projected supply gas until an agreement can be finalized with a second gas supplier. IEC has been in protracted talks with BG over its offshore Gaza gas reserves but no deal has been agreed. Earlier plans to take delivery of Egyptian gas have been frozen since late 2000.

## **ALGERIA**

### **ABB, Sarpi Awarded \$90Mn Berkine Surface Facilities Contract**

A consortium comprising ABB and Sarpi (a Sonatrach and ABB subsidiary) on 22 July signed a \$90mn contract with Sonatrach for the construction of surface facilities at the Sonatrach-operated Bir Berkine and Northern Bir Berkine fields in blocks 404b and 403 respectively, in the Berkine basin southeast of Algiers. Bids for the contract were opened in a public session on 22 May. The contract involves the construction of oil production and treatment units with a capacity of 25,000 b/d and is expected to be complete within 28 months to allow production to start in September 2005.

### **Algeria/Tunisia JV Wins Kaboudia Offshore Block**

The Algerian-Tunisian joint venture Numhydh (jointly owned by Sonatrach and ETAP) was awarded the Kaboudia exploration block offshore Tunisia on 18 July. Numhydh was awarded a reconnaissance contract for seismic work in Algeria's onshore Illizi area earlier in the month (*MEES*, 21 July). The Kaboudia block (E4) is located in Tunisia's eastern offshore area and covers 4,500 sq km. Six wells were drilled on the block between 1974 and 1993 (*MEES*, 9 October 2000). The two countries signed additional agreements concerning the distribution of petroleum products and extended an agreement regarding the supply of Algerian LPG to Tunisia.

## **CASPIAN**

### **Azerbaijan, Georgia And Turkey Sign Security Protocol For Energy Corridor**

Azerbaijan, Georgia and Turkey signed in Baku on 23 July a security protocol relating to the proposed crude and gas pipelines that will run through their territories. The new intergovernmental agreement is designed to assure the foreign companies taking part in the construction and operation of the Baku-Tbilisi-Ceyhan (BTC) crude pipeline and the South Caucasus Pipeline (SCP) that the three governments will each take responsibility in its territory for guarding the security of the two pipelines which will make up the East-West Energy Corridor. The protocol covers the actual physical protection of the pipelines, the implementation of anti-terrorism measures, information exchanges and joint trading. BP, which is leading the consortiums supporting both projects, will be involved in the coordination of the security measures. The BTC will carry crude from Azerbaijan's offshore oilfields and other sources to Turkey's Mediterranean port of Ceyhan, while the SCP will carry natural gas from Azerbaijan's offshore Shah Deniz gasfield to Turkey's eastern gas hub at Ezurum (*MEES*, 3 March).

## **MAURITANIA**

### **Woodside To Drill Four Mauritania Offshore Wells In 2H 2003**

Woodside Petroleum has signed a letter of intent with Smedvig Offshore for the drill ship West Navigator to drill up to four wells in offshore Mauritania during second half 2003, partner Hardman Resources said in a statement on 16 July. The rig is expected to arrive in the third week of August after North Sea work is completed. Hardman said that following meetings between the PSC Area B partners in July, the joint venture has agreed to drill two firm wells in the 2003 drilling campaign. A third well will be proposed in PSC Area B on the basis of a number of prospects currently under consideration. In addition, a fourth well is to be drilled in the Dana Petroleum-operated PSC Block 7 (For map of offshore Mauritania, see *MEES*, 22 August 2002).

Details of the planned wells are:

- Early Development – Appraisal well on Chinguetti. It is intended to complete this well suitably for long term production with measures in place to control sand inflow. An extended production test (1-2 week production period) is also planned. The well would thereafter be suspended pending commissioning of the production facilities of the field in late 2005. The information gained from this early development well is expected to provide confirmation of the development scheme and has the potential to provide significant cost savings in the drilling and completion of further development wells, Hardman said.

- Tiof Prospect (PSC Area B): Targeting Miocene channel sandstones within structural closure, adjacent to a salt dome, approximately 25km north of the Chinguetti field. The prospect is in 1,130ms water depth and has estimated potential of 153mn barrels (mean recoverable volume).
- Second exploration well in PSC Area B: A number of prospects are under consideration including: Tevèt, a Miocene channel sandstone prospect situated between the Chinguetti and Banda Fields, and Poune, an Upper Cretaceous prospect. A decision on whether to drill and the preferred prospect will be made on completion of further studies and after drilling the Chinguetti well.
- PSC Block 7 well: A large structural closure with multiple reservoir targets in water depth of approximately 1,700ms. The Block 7 joint venture has agreed to drill this well at the end of the Woodside drilling program.

Hardman upgraded the recoverable oil reserve estimate for the Chinguetti field to 95mn barrels earlier this year (*MEES*, 3 March). Hardman Managing Director Ted Ellyard said on 16 July that the joint venture is expected to make a declaration of commerciality for the Chinguetti field in October 2003, after the results of the early development well have been evaluated. He said that tendering and negotiations for the production facilities and financing arrangements would be finalized during a three-five month period thereafter. "The final investment decision is therefore expected to occur about March 2004. Drilling of the development wells, installation and commissioning of the production facilities will take place during the second half of 2004 and into 2005 with first oil production expected in the second half of 2005," Mr Ellyard said. "Studies completed to date indicate that the field could achieve a full field production rate of 75,000 b/d in the initial one to two years," he added. Mr Ellyard said that full field development to first oil would cost some \$400mn.

## **CONFERENCES**

### **AICC To Hold Iraq Reconstruction Conference In Amman In August**

The American-Iraqi Chamber Of Commerce (AICC) plans to hold an Iraq Reconstruction Conference on 3-4 August at the Grand Hyatt Hotel in 'Amman. A similar conference will be hosted in Washington DC in September by AICC and NUSACC (National US Arab Chamber of Commerce). More details from: AICC (Washington DC): Sam Kubba, CEO and Chairman, Tel: (240) 893 7663. E-mail: sk@aicc.us Website: www.aicc.us

### **MEGAS 03 Gas Summit In Cairo In October**

The 9<sup>th</sup> annual Middle East Gas Summit (MEGAS 03), organized by IBC Gulf Conferences, will be held in Cairo on 20-23 October. An opening ministerial and keynote session will include contributions from Oil Minister Sameh Fahmy, Electricity and Power Minister Hassan Yunis, EGPC Chairman Ibrahim Salih, EGAS Chairman Muhammad Tawila, EChem Chairman Shereif Ismail, and Gaz de France Group President Jacques Deyirmendjian. More details from Susan Webb, General Manager, IBC Gulf Conferences, Tel: +971 4 336 9992, Fax: + 971 4 336 0116, Email: susan.webb@ibc-gulf.com, Website: www.ibcgulf.com/MEGAS.

# Financial And Banking News

## **BANK RESULTS**

### **UAE Banking Sector Sees Continuation Of Positive Results In 2002**

The UAE banking sector has posted another good year of results despite a climate of regional tension, a sluggish international economy and low interest rates. According to the annual *MEES* survey of 19 locally incorporated banks, sector-wide profits rose by just over 4% from \$1,107mn in 2001 to \$1,153mn in 2002, with most banks maintaining healthy profitability, although some registered a marginal deterioration of the bottom line. Of the five banks which together dominate the sector, Emirates Bank International group (EBI), National Bank of Abu Dhabi (NBAD), National Bank of Dubai (NBD) and Mashreqbank all saw their profitability increase over the year, while Abu Dhabi Commercial Bank (ADCB) saw a slight decline in its fortunes.

In the next tier of medium-sized banks, Union National Bank (UNB) saw continued strong growth in 2002, increasing profits by over 23% against 2001 to \$82mn. The other medium-sized and smaller banks on the whole registered more modest growth rates. Aggregate income for the sector reached \$2,354mn, of which interest income made up 60% while other income (including fees and commission income) accounted for the remaining 40%. Sector-wide costs, including provisions, rose to \$1,016mn – an increase of almost 10% against 2001.

NBD remains the largest bank in the sector in terms of equity and saw its share capital increase to \$1,495mn in 2002, from \$1,260 in 2001 – a rise of over 18%. ADCB, EBG, NBAD, and Mashreqbank all saw their equity rise between 2001 and 2002, while the sector as a whole registered an 11% increase in equity to reach \$9,047mn. ADCB remained the largest bank in terms of its capital, which stood unchanged at \$340mn, but NBD edged closer, increasing its capital by 25% to reach \$294mn. The capital of the other large banks remained unchanged, while a number of the smaller banks increased their capital levels and the total for the sector rose 4.4% to reach \$2,998mn. In terms of assets, NBAD leapt ahead of NBD to lead the table at \$10,631mn. Sector-wide assets increased 12% to \$61,947mn. Customer deposits grew by over 15% to \$44,506mn, reflecting high liquidity in the economy, and loans were up over 16% to \$30,794mn.

Sector-wide performance ratios remained largely unchanged compared to last year. Return on average assets (ROAA) came in at 2.24%, down slightly from 2.28% in 2001. All but five banks achieved an ROAA of over 2%, with National Bank of Umm al-Quwain leading the field with an ROAA of 3.93%, followed closely by United Arab Bank (UAB) at 3.78%. UAB led the rankings in terms of return on average equity (ROAE), posting a healthy 18.93%. All the other banks bar two also registered an ROAE of over 10%, and the average for the sector stood at 12.57%, up slightly from 12.39% last year. Income to cost ratios ranged from 2.01 for the National Bank of Ras al-Khaimah to 4.86 for ADCB, and averaged 2.87 for the sector. Loans to asset ratios remained below the 75% mark. UAB continues to have the highest ratio at 75.04%, while the sector average stands at 53.31%.

NBD had a strong year in 2002, posting a rise in profits of 26% against 2001, and continuing the positive trend seen since the early 1990s. Net interest income for the bank was up 30% year-on-year, showing that the low interest rate environment has not stopped the bank from realizing healthy income on customer deposits and loans, which were up by 8% and 28% respectively. Corporate and retail banking business continued to grow, the Directors' report noted, supported by the Treasury and investment side of the business. A rise in corporate loans was the driver behind the increase in the bank's overall loan portfolio, while the Treasury was able to enhance yields, and made a major contribution to the year's results, according to NBD Chairman Dr Khalifa Sulaiman. Costs increased by 19%, mainly as a result of higher depreciation charges arising from the bank's investment in technology, noted the report. NBD opened a representative office in Tehran in November 2002 as part of its strategy of focusing on business opportunities in the Gulf.

For Mashreqbank, 2002 was the first year of its strategic plan, and the bank had a good year, with the positive trend continuing into 2003, according to a source at the bank. In common with the rest of the UAE banking

sector, Mashreqbank is focusing on fee-based services such as cash and investment management in order to diversify its revenue base away from the more volatile interest income. Another feature of Mashreqbank's strategy which it has in common with other players in the sector is its focus on the GCC market. The bank has pulled out of Pakistan and Sri Lanka recently and is expected to pull out of India in the near future, although it is maintaining an overseas presence in Egypt, London, New York and Hong Kong. It also has a new branch in Doha, which is a major focus of its operations, especially in corporate banking.

EBI also left the Pakistan market in 2002 with the sale of its operations there to Union Bank Ltd (*MEES*, 1 July 2002), generating Dh30mn (\$8.2mn) and helping to boost its non-interest income. EBI has been granted a full bank license in Saudi Arabia as part of its regional expansion. Meanwhile, National Bank of Sharjah completed its conversion to become the third fully Islamic bank after Abu Dhabi Islamic Bank and Dubai Islamic Bank midway through the year. The changeover was made as a strategic decision by shareholders, said a source at the bank, and the transformation brought with it costs which adversely affected the bank's profitability. However, he noted, the transformation was made while maintaining high liquidity to minimize risk, and the result was a smooth transition, despite the fall in profit.

The IMF, following its 2002 Article IV consultations with the UAE, noted that the banking system in the UAE remains strong, broadly profitable and well supervised and capitalized. The system benefits from relatively low operating costs and widening margins between deposit and lending interest rates, it noted. The UAE authorities have also been strengthening the financial sector in line with the recommendations of the 2001 Financial Sector Assessment Program (FSAP). This has included the approval of a federal law in January 2002 that fully incorporates the FATF 40 (Financial Action Task Force on Money Laundering) recommendations, and the eight special recommendations dealing with terrorist financing. A comprehensive system of overall risk management has also been adopted, noted the IMF, while a draft banking law clarifies issues on Islamic banking, disclosure, the responsibilities of Boards of Directors, strengthening the supervisory role of the Central Bank of the UAE, and the supervision of the "hawala" system of informal money transfers.

#### UAE Banks: Balance Sheets, 2000-02 (\$Mn)

Bank	Year	Equity	Capital	Assets	Loans	Due Banks	Due To Banks	Customer Deposits	NPLs
National Bank Of Dubai	2002	1,494.8	294.2	9,573.7	2,515.6	2,698.8	609.6	7,394.1	115.3
	2001	1,260.3	235.5	8,896.8	1,958.0	3,435.8	670.8	6,846.2	103.4
	2000	1,213.0	235.5	7,667.5	1,902.9	3,140.0	527.6	5,803.9	82.5
Abu Dhabi Commercial Bank	2002	1,197.3	340.3	7,537.0	4,737.4	1,437.7	934.0	4,972.2	980.9
	2001	1,120.1	340.3	7,240.1	4,452.9	1,492.4	853.3	4,825.9	955.6
	2000	1,026.2	340.3	6,888.5	4,702.4	1,309.3	767.5	4,659.0	896.5
Emirates Bank International	2002	1,227.1	250.0	7,409.7	5,149.8	737.7	643.3	4,494.1	157.2
	2001	1,125.1	250.0	6,404.9	3,957.2	904.6	835.6	3,787.0	186.9
	2000	1,021.1	200.0	5,334.2	3,062.4	1,121.4	385.7	3,285.3	658.6
National Bank Of Abu Dhabi	2002	1,049.0	256.5	10,630.6	6,758.4	1,598.2	1,213.0	8,057.1	212.9
	2001	956.8	256.5	8,785.7	5,538.6	1,064.9	1,682.4	5,871.3	203.7
	2000	856.9	256.5	9,925.0	5,261.4	2,656.0	1,638.8	7,111.8	186.0
Mashreqbank	2002	920.2	195.0	6,447.9	3,425.5	1,242.5	688.9	4,550.4	373.8
	2001	825.4	195.0	6,183.6	2,869.5	1,007.2	726.2	4,388.9	349.9
	2000	738.6	195.0	6,016.7	2,942.7	929.4	669.0	4,382.6	680.9
Arbift	2002	343.7	155.3	1,578.7	387.6	1,040.4	843.2	353.8	21.5
	2001	335.9	155.3	1,573.4	349.1	1,115.4	945.3	271.7	29.3
	2000	358.6	155.3	1,510.5	336.2	973.3	869.7	260.8	31.9
Union National Bank	2002	462.3	223.8	4,006.3	2,364.1	988.5	314.1	3,181.5	-
	2001	401.5	203.6	3,614.1	2,156.5	803.6	215.1	2,956.1	-
	2000	365.9	185.1	3,301.4	2,030.3	481.9	159.8	2,720.3	179.7

<b>Bank (Cont'd)</b>	<b>Year</b>	<b>Equity</b>	<b>Capital</b>	<b>Assets</b>	<b>Loans</b>	<b>Due Banks</b>	<b>Due To Banks</b>	<b>Customer Deposits</b>	<b>NPLs</b>
Dubai Islamic Bank	2002	428.5	272.4	5,335.6	na	68.7	66.0	4,624.8	-
	2001	336.8	272.4	4,177.1	na	120.2	58.9	3,593.7	-
	2000	317.3	272.4	3,207.1	na	34.4	25.1	2,662.1	-
Commercial Bank Of Dubai	2002	401.1	122.8	2,165.0	1,332.8	338.1	257.2	1,456.5	77.2
	2001	374.0	122.8	2,003.2	1,237.7	365.6	219.2	1,387.3	79.7
	2000	342.7	111.7	1,946.0	1,277.4	221.1	88.2	1,479.1	58.9
Middle East Bank	2002	209.3	136.2	547.0	150.6	6.5	0.1	307.1	-
	2001	195.7	136.2	673.5	325.1	3.6	2.6	395.4	-
	2000	180.4	136.2	660.1	332.3	9.3	2.0	421.4	-
First Gulf Bank	2002	182.0	101.9	1,356.9	757.1	231.0	52.4	1,091.6	138.4
	2001	151.7	98.1	938.4	467.1	210.0	3.5	759.6	140.9
	2000	136.3	98.1	652.4	382.6	214.2	10.2	479.6	129.0
National Bank of Ras al-Khaimah	2002	157.5	68.1	797.8	536.6	130.9	0.6	629.3	14.1
	2001	147.3	68.1	660.2	480.5	97.4	15.2	489.8	11.8
	2000	141.2	68.1	508.3	372.0	85.6	23.8	335.3	22.7
National Bank of Fujairah	2002	168.6	100.2	731.1	437.1	34.1	33.0	516.3	34.4
	2001	151.5	89.9	718.1	413.0	35.1	73.3	480.9	29.0
	2000	138.5	81.7	752.7	436.5	94.9	72.9	521.6	29.3
National Bank of Umm al-Quwain	2002	131.9	68.1	456.4	306.7	44.4	7.6	306.7	28.7
	2001	126.1	68.1	466.2	315.5	70.5	4.9	322.8	25.6
	2000	122.2	68.1	462.0	317.4	32.3	0.7	327.5	22.5
Investbank	2002	143.5	101.1	749.5	532.7	106.3	4.4	582.0	103.1
	2001	130.4	89.9	700.6	465.8	159.2	4.0	545.8	102.3
	2000	126.2	81.7	545.5	434.9	164.2	0.6	534.2	112.0
National Bank of Sharjah	2002	181.7	100.0	653.3	36.2	50.2	15.5	431.1	-
	2001	188.5	95.3	557.6	355.6	139.5	54.3	300.9	-
	2000	144.9	78.0	505.4	362.1	75.1	32.8	314.0	129.6
United Arab Bank	2002	126.0	74.9	575.1	431.6	67.8	29.6	410.4	-
	2001	116.7	68.1	484.7	365.0	68.2	17.1	341.8	18.2
	2000	105.3	61.9	464.8	341.3	59.8	25.0	325.3	17.4
Bank of Sharjah	2002	114.4	65.3	604.9	361.4	88.2	5.4	479.1	18.6
	2001	106.6	65.4	525.0	280.5	86.2	0.1	409.3	14.0
	2000	100.6	59.9	514.3	298.2	101.0	5.1	399.3	15.4
Commercial Bank International	2002	107.7	72.7	790.3	572.5	129.7	5.0	668.2	67.3
	2001	93.2	62.7	652.0	469.6	94.6	7.0	542.0	47.6
	2000	82.7	54.5	542.5	400.6	64.4	10.8	440.3	50.4
Total	2002	9,046.7	2,998.3	61,946.9	30,793.8	11,039.4	5,724.6	44,506.2	2,763.7
	2001	8,143.6	2,873.2	55,255.1	26,457.2	11,273.9	6,388.9	38,516.6	2,797.5
	2000	7,518.5	2,740.1	51,404.9	25,193.7	11,767.5	5,315.3	36,463.3	3,303.2

**UAE Banks: Profit And Loss Statements, 2000-02**  
(\$Mn)

<b>Bank</b>	<b>Year</b>	<b>Net Profit</b>	<b>Net Interest Income</b>	<b>Other Income</b>	<b>General/ Admin Expenses</b>	<b>Provisions Other Expenses</b>
National Bank of Dubai	2002	154.9	202.6	62.6	100.1	10.2
	2001	123.0	156.2	53.7	83.9	2.9
	2000	111.4	141.2	44.7	74.5	0.1
Abu Dhabi Commercial Bank	2002	160.7	193.9	57.7	51.7	43.0
	2001	167.6	210.4	54.0	47.7	48.9
	2000	166.4	205.9	51.1	48.0	42.7
Emirates Bank International	2002	160.3	165.5	105.8	118.0	-7.0
	2001	151.4	165.0	86.7	117.3	-17.0
	2000	142.8	186.8	79.7	113.3	10.4
National Bank of Abu Dhabi	2002	178.1	194.5	106.7	102.8	20.3
	2001	165.5	200.5	74.6	96.2	13.4
	2000	139.8	188.5	61.0	92.1	17.7
Mashreqbank	2002	137.5	183.8	152.7	135.4	55.8
	2001	110.5	172.9	137.6	130.3	61.0
	2000	95.5	166.5	128.1	126.7	72.5
Arbift	2002	7.9	22.5	19.2	10.0	23.8
	2001	11.0	26.6	16.1	12.2	19.6
	2000	29.4	26.7	19.6	15.5	1.5
Union National Bank	2002	81.8	120.1	45.4	50.5	7.6
	2001	66.2	101.6	48.6	49.9	6.8
	2000	55.1	80.4	46.9	51.1	21.1
Dubai Islamic Bank	2002	43.5	-	240.1	59.8	14.4
	2001	41.5	-	227.2	45.5	13.9
	2000	33.0	-	206.0	45.0	128.0
Commercial Bank of Dubai	2002	63.5	73.4	27.9	31.6	4.1
	2001	59.0	74.2	20.8	28.8	4.3
	2000	54.9	74.4	20.5	32.0	8.0
Middle East Bank	2002	20.6	28.6	5.0	15.5	-2.5
	2001	19.7	36.3	5.6	22.9	-0.7
	2000	18.1	39.3	5.8	22.8	4.2
First Gulf Bank	2002	21.9	31.0	13.8	19.3	3.6
	2001	16.8	23.8	8.6	13.1	2.6
	2000	13.7	21.9	4.2	10.2	2.2
National Bank of Ras al-Khaimah	2002	20.6	40.9	12.4	26.6	6.2
	2001	16.4	31.2	8.9	18.8	4.9
	2000	13.6	26.4	5.2	12.4	5.6
National Bank of Fujairah	2002	22.0	19.5	21.1	14.2	4.5
	2001	19.1	19.2	20.2	13.4	6.9
	2000	14.0	16.1	18.7	13.1	7.7
National Bank of Umm al-Quwain	2002	18.1	23.7	6.5	8.2	3.9
	2001	16.1	23.7	6.1	8.6	5.1
	2000	16.2	23.2	6.0	10.6	2.4
Investbank	2002	23.6	29.0	12.7	9.9	8.2
	2001	21.8	27.1	10.4	9.2	6.6
	2000	19.9	24.7	10.1	6.5	8.5
National Bank of Sharjah	2002	15.2	9.2	23.8	13.4	4.4
	2001	20.8	21.6	8.7	10.8	-1.4
	2000	24.8	21.0	4.4	8.9	-8.3

Bank (Cont'd)	Year	Net Profit	Net Interest Income	Other Income	General/Admin Expenses	Provisions Other Expenses
United Arab Bank	2002	20.0	26.3	11.2	14.3	3.2
	2001	19.6	24.5	10.4	12.9	2.4
	2000	17.8	23.7	9.9	12.5	3.3
Bank of Sharjah	2002	16.1	19.2	8.0	8.8	2.2
	2001	13.7	15.5	7.1	8.2	0.7
	2000	13.2	17.4	6.3	7.7	2.9
Commercial Bank International	2002	18.0	25.9	11.8	13.4	6.3
	2001	15.0	21.7	8.8	11.7	3.8
	2000	13.7	22.3	7.1	10.0	5.7
Total	2002	1,152.5	1,409.6	944.5	803.5	212.1
	2001	1,106.6	1,352.0	814.1	741.6	184.6
	2000	993.1	1,306.5	735.5	712.7	336.2

### UAE Banks: Selected Ratios, 2001-02

ROAA				ROAE			
	2002	2001		2002	2001		
1 National Bank of Umm al-Quwain	3.93	3.47	(4)	1 Union National Bank	18.93	17.24	(3)
2 United Arab Bank	3.78	4.12	(1)	2 Commercial Bank International	17.94	17.04	(4)
3 Middle East Bank	3.37	2.96	(6)	3 National Bank of Abu Dhabi	17.76	18.25	(1)
4 Investbank	3.26	3.49	(2)	4 Investbank	17.25	16.97	(5)
5 Commercial Bank of Dubai	3.05	2.99	(5)	5 United Arab Bank	16.52	17.64	(2)
6 National Bank of Fujairah	3.03	2.60	(9)	6 Commercial Bank of Dubai	16.40	16.45	(6)
7 Bank of Sharjah	2.85	2.63	(8)	7 Mashreqbank	15.75	14.13	(8)
8 National Bank of Ras al-Khaimah	2.82	2.81	(7)	8 Bank of Sharjah	14.57	13.20	(10)
9 National Bank of Sharjah	2.52	3.91	(3)	9 National Bank of Umm al-Quwain	14.04	12.96	(12)
10 Commercial Bank International	2.50	2.51	(10)	10 Abu Dhabi Commercial Bank	13.87	15.61	(7)
11 Emirates Bank International	2.32	2.58	(11)	11 National Bank of Fujairah	13.73	13.17	(11)
12 Abu Dhabi Commercial Bank	2.18	2.37	(12)	12 Emirates Bank International	13.63	14.10	(9)
13 Mashreqbank	2.18	1.81	(15)	13 National Bank of Ras al-Khaimah	13.49	11.38	(16)
14 Union National Bank	2.15	1.91	(14)	14 First Gulf Bank	13.15	11.67	(15)
15 First Gulf Bank	1.91	2.11	(13)	15 Dubai Islamic Bank	11.37	12.70	(13)
16 National Bank of Abu Dhabi	1.84	1.77	(16)	16 National Bank of Dubai	11.24	9.95	(18)
17 National Bank of Dubai	1.68	1.49	(17)	17 Middle East Bank	10.17	10.50	(17)
18 Dubai Islamic Bank	0.91	1.13	(18)	18 National Bank of Sharjah	8.24	12.47	(14)
19 Arbift	0.50	0.71	(19)	19 Arbift	2.33	3.16	(19)
Income/Cost				Loans/Assets			
	2002	2001		2002	2001		
1 National Bank of Ras al-Khaimah	2.01	2.13	(2)	1 National Bank of Sharjah	5.53	63.77	(13)
2 Middle East Bank	2.17	1.83	(1)	2 Arbift	24.55	22.18	(2)
3 Emirates Bank International	2.30	2.15	(3)	3 National Bank of Dubai	26.28	22.01	(1)
4 First Gulf Bank	2.32	2.48	(5)	4 Middle East Bank	27.54	48.27	(4)
5 National Bank of Sharjah	2.46	2.79	(12)	5 Mashreqbank	53.13	46.40	(3)
6 Mashreqbank	2.49	2.38	(4)	6 First Gulf Bank	55.80	49.78	(5)
7 United Arab Bank	2.62	2.71	(10)	7 Union National Bank	59.01	59.67	(8)
8 National Bank of Dubai	2.65	2.50	(6)	8 Bank of Sharjah	59.74	53.43	(6)
9 Commercial Bank International	2.82	2.60	(7)	9 National Bank of Fujairah	59.79	57.52	(7)
10 National Bank of Fujairah	2.87	2.94	(9)	10 Commercial Bank of Dubai	61.56	61.78	(10)
11 National Bank of Abu Dhabi	2.93	2.86	(13)	11 Abu Dhabi Commercial Bank	62.86	61.50	(9)
12 Bank of Sharjah	3.08	2.74	(11)	12 National Bank of Abu Dhabi	63.57	63.04	(12)
13 Commercial Bank of Dubai	3.21	3.30	(14)	13 National Bank of Umm al-Quwain	67.20	67.67	(15)
14 Union National Bank	3.28	3.01	(8)	14 National Bank of Ras al-Khaimah	67.26	72.79	(17)
15 National Bank of Umm al-Quwain	3.68	3.46	(16)	15 Emirates Bank International	69.50	61.78	(10)
16 Dubai Islamic Bank	4.02	4.99	(18)	16 Investbank	71.07	66.49	(14)
17 Arbift	4.17	3.52	(15)	17 Commercial Bank International	72.44	72.03	(16)
18 Investbank	4.21	4.08	(17)	18 United Arab Bank	75.04	75.31	(18)
19 Abu Dhabi Commercial Bank	4.86	5.54	(19)				

### **GIB Posts \$61.5Mn Profits For First Half 2003**

Gulf International Bank (GIB) has announced consolidated net income after tax of \$61.5mn for the first half of 2003, down from \$70.5mn in the first half of 2002. Net interest income stood at \$86.6mn, down 15.3% from \$102.3mn in 2002 as low interest rates brought about reduced earnings on the bank's net free capital, said GIB. Improved margin income from both the core banking activity and the securities portfolio was not enough to make up for these lost earnings. Provisions for credit losses came to \$39.3mn, compared to \$39.8mn in first half 2002. Other income pulled back some of the lost ground on interest income, up \$11.7mn on first half 2002 to reach \$70.8mn. This was due to "strong advances in both trading income and investment banking and management fees," GIB said. Trading income came in at \$33.3mn, with investment banking and management fees bringing in \$9.6mn. Operating expenses were up 11% to \$56.6mn, principally due to the impact of the weaker US Dollar on foreign currency denominated expenses. GIB's consolidated total assets stand at \$17bn, up \$771mn on year end 2002 largely as a result of a rise in the volume of available-for-sale securities of \$306mn and an increase in loans and advances of \$347mn. Shareholders' equity at the end of the first half of 2003 stood at \$1.24bn.

## **REGIONAL BANKING**

### **Government Debt Servicing Still Pressuring Lebanese Banks, Says Moody's**

The financial strength ratings (FSRs) of Lebanon's banks continues to come under negative pressure from their exposure to a government which is severely strained by its onerous debt and debt-servicing, said Moody's Investors Service in a *Banking System Outlook* report on Lebanon published in June. The three banks that Moody's rates (Banque Audi, Byblos Bank and Banque du Liban et d'Outre Mer (BLOM)) all have a financial strength rating of D+ with a negative outlook and foreign currency deposit rating of B2/Not Prime (negative outlook), while BLOM and Byblos also have a subordinated debt rating of B1 (negative outlook).

The banks' FSRs continue to be constrained by the difficult, albeit slightly improving, operating environment in Lebanon, said Moody's noting that over the past few years, slow economic growth has negatively affected the Lebanese corporate sectors and with it the asset quality of banks. Excluding an economic crisis or a sudden growth in loans, Moody's expects that the aggregate level of non-performing loans (NPLs) for the entire banking sector will continue its gradual worsening trend albeit at a slower pace, although provisioning is expected to improve.

Lebanese banks are expected to remain liquid in foreign currency going forward. However, long-term placement with the central bank or lending to the government at relatively high real rates may affect banks' core liquidity ratios while increasing their risk profile, warned Moody's. The banks' capital base has improved markedly over the past few years through new capital injection and retained earnings. However, the system's economic capital remains relatively low in light of the high exposure to government securities.

### **Negative Outlook Reflects Exposure To Government Debt**

Moody's negative outlook on all the ratings of Lebanese banks is largely a reflection of a difficult operating environment together with the banks' significant exposure to a government with weak financial fundamentals. More than 34.6% of Lebanon's total banking assets is exposed to the Lebanese government debt (of which 59.3% is in Lebanese pound T-bills and 40.7% in foreign currency Eurobonds), which is rated B2 for foreign currency debt (negative outlook) and B3 for Lebanese pound debt. Until sustainable improvements in the government finances and more stability in the macro-economic environment are exhibited, the negative outlooks are unlikely to change.

Currently, the FSRs have limited upside potential. However, if the country's ratings were to be upgraded and the banks' exposures to the state diminish while their asset quality improves, higher FSRs could be envisaged. Conversely, the high credit risk associated with the government's domestic debt is adding to the negative pressure on the banks' FSRs and may lead to downgrades if banks do not manage to reduce their exposure to the government or if the latter's debt dynamic does not improve.

The fiscal imbalances in Lebanon that have led to some of the highest debt ratios among rated sovereigns constitute a threat to the stability and the health of the Lebanese banking sector. Total debt to GDP was 183.8% by the end of 2002, and debt servicing has consumed more than 79% of the government's total revenues in the same year. The enormous fiscal burden imposed by this debt had, until recently, eroded confidence in the Lebanese Pound resulting in a dollarization rate of bank deposits, which peaked at the end of May 2002, reaching 74.24%. However, the reforms that led to the Paris II agreement late in 2002 have had a significant positive impact on the overall confidence in the Lebanese financial markets. The dramatic decline in interest rates that took place in the weeks following the agreement late last year is a reflection of the restitution of such confidence. The dollarisation rate of deposits, which is a proxy index to the confidence in the Lebanese Pound, declined to reach 68.4% at the end of February 2003. As part of the Paris II agreement, the Lebanese government has committed to implementing further reforms towards achieving macro-economic stability.

However, despite these positive developments, Moody's sovereign ratings on Lebanon remain unchanged. The unchanged ratings take into account the opportunity for an improved fiscal stand brought about by the Paris II agreement, but mainly reflect a cautious view regarding the difficulties in the implementation of tighter fiscal policies and privatization plans amidst an unstable geopolitical environment. A longer track record of fiscal discipline and sovereign debt reduction would be necessary conditions for improvements in the country's rating outlook, said Moody's.

On the positive side, the likelihood of support from the Lebanese monetary authorities, particularly for large banks, is high. In addition, support from core shareholders in the event of banks facing financial difficulties would be forthcoming. Such a high likelihood of support is a significant rating driver for the Lebanese banks' deposit ratings.

#### **Consolidation Expected To Continue In Overbanked Lebanon**

However, Moody's notes that with around 54 banks serving a population of 3.5mn and an estimated GDP of \$17.4bn in 2002, the number of commercial banks in the Lebanese banking system (which has \$53bn in assets) is one of the largest compared to any other Arab country (excluding offshore banks). However, round 65% of the banks are small, with individual total assets of less than \$500mn. The banking sector is concentrated at the top with the 10 largest banks controlling around 70% of the system's total assets. The long-term viability of many of the small and medium-sized banks is questionable, as they typically have a very narrow franchise base and lack the technological sophistication that characterizes their larger peers.

The consolidation of the banking system, which started a few years ago, is expected to continue, and its pace would probably accelerate if the health of the government's finances were to improve. The Central Bank of Lebanon (CBL) has facilitated this consolidation process by providing financial incentives through long-term soft loans. However, although a mega-merger between two or more large Lebanese banks is still possible, the CBL seems skeptical as to the benefits of such a merger, and for now prefers a consolidation that includes smaller banks. The total number of commercial banks in the system has been reduced from 66 in 1999, to 54 in December 2002.

Moody's views the consolidation process positively from a banking system standpoint. Such a process will result in a more efficient banking system that is less vulnerable to shocks in the economy. At the same time, not all attempts to acquire banks have been successful (such as Byblos and BLC; Audi and BLF; Saradar and BLF). Moreover, becoming a larger bank in Lebanon does not necessarily enhance a bank's risk profile. Larger banks tend to attract more depositors in Lebanese pounds which are typically placed in what Moody's considers high-risk Lebanese government t-bills.

#### **Consumer Lending Showing Good Potential In Lebanon**

Lebanese banks are increasingly looking to expand their retail banking services and initiatives. At present, retail loans comprise on average only around 12-15% of the total loan book of the Lebanese banking sector. Moody's believes that the retail banking market is likely to expand significantly in coming years given the relatively underdeveloped mass market. At the moment, consumer lending is probably one of the few areas with a good potential for growth in the country, notes Moody's.

The total assets of the banking system grew by 12% year-on-year to reach \$53.6bn at the end of February 2003. Deposits grew by 9.1% during the same period to reach \$37.1bn. The Paris II agreement has had a positive impact on interest rates and had rebuilt confidence in the Lebanese pound, pushing away the threat of devaluation. The average cost of deposits in Lebanese pounds dropped by more than 146bps to reach 8.68% at the end of February 2003, while the dollarization of deposits declined from a 10-year high of 74.24% at the end of May 2002 to 68.4% at the end of February 2003.

## **IRAQ RECONSTRUCTION**

### **CPA Sets Up Trade Bank Of Iraq To Revive Ailing Economy**

The Coalition Provisional Authority (CPA) announced on 22 July that it had established a new bank – Trade Bank of Iraq – to help revive the country’s ailing economy and had approached international banks to submit proposals to assist in its creation. The bank is being set up to allow Iraqi ministries and oil firms to begin making large purchases abroad, according to a report in the *Wall Street Journal* of 22 July. The report adds that US administrators will select an international consortium of banks by August to run the bank. The top US Treasury Department advisor in Baghdad, Peter McPherson, was quoted in the report as saying that the establishment of the bank will mark a “good first step to get Iraq back into the international financial world.” According to US officials the winning consortium will not be involved in any way in financing future Iraqi oil sales.

The CPA said in a statement that the new bank would help “facilitate the transition from state-owned enterprises to greater privatization.” It will have an authorized capital of \$100mn and will be independent from the Central Bank of Iraq. The statement added that existing Iraqi banks are presently ill-equipped to support import-export trade activities and that they lack sufficient expertise and international contacts. At the same time it notes that “financial institutions in Iraq are fully engaged in reestablishing basic banking services and have limited capacity for specialized trade services.”

### **Judge Issues Temporary Restraining Order On \$653Mn In Iraqi Assets Held In The US**

A US federal judge, Richard Roberts of the US District Court for the District of Columbia, on 18 July issued a temporary 10-day restraining order on \$653.07mn in confiscated or vested Iraqi funds held by the US Treasury. The order was made following a ruling by Judge Roberts on 7 July (*MEES*, 14 July) in which he awarded a total of over \$959mn in punitive (\$306mn) and compensatory (\$653mn) damages to 17 Americans held as prisoners in Iraq during the 1991 Gulf war and 37 members of their immediate families. The case was brought in April 2002 against Iraq, Saddam Husain and the Iraqi Intelligence Services for injuries, suffering and emotional distress suffered by the complainants as a result of their torture while in captivity.

Judge Roberts made the order after hearing arguments from attorneys for the former prisoners of war and the government, while further briefs will be presented within the 10-day period. The order restricts the use of the remaining \$1.4bn in Iraqi money still held in a Federal Reserve Bank of New York account from the \$1.7bn in funds frozen in 1990 following the Iraqi invasion of Kuwait. However, according to a Treasury Department spokesman, it will have no effect on transfers to Baghdad already scheduled as operating expenses for the emerging Iraqi government. According to Tony Onorato, a lawyer for the former prisoners, “it’s not our contention to hamper the reconstruction effort [in Iraq]...but with specific regard to these frozen assets, Congress has made a determination, and we feel it ought to be carried out by the executive branch.” However, if the complainants are successful in claiming the frozen Iraqi funds, it will be a severe blow to nascent reconstruction efforts.

## **ENERGY FINANCE**

### **SABIC Records \$851Mn Profit In First Half 2003**

The Saudi Basic Industries Corporation (SABIC) on 21 July announced profits for the first half of 2003 of SR3,190mn (\$850.6mn), a strong rise compared to the SR985mn profit (\$262.6mn) earned in the first half of 2002. The results include second quarter net profits of SR1,794mn (\$478.4mn) and first quarter profits of SR1,396mn (\$372.2mn). SABIC recorded a full year profit for 2002 of SR2,844mn (\$758.4mn), a 60% increase over 2001 (*MEES*, 30 June and 3 February). According to SABIC Vice Chairman and CEO Muhammad al-Mady, the increase in profits for the first half of 2003 was due to higher product prices and volumes. In the second quarter

prices stabilized, despite a slight weakness in the early part of the quarter, which was caused largely by global uncertainty as well as unsettled market conditions in much of Asia because of market reaction to the SARS outbreak, he said. Production in the first half of 2003 reached 19.6mn tons, a 10% increase over the same period in 2002, while the volume of sales was also up 10% to 15.2mn tons. Mr Mady noted that the increased volumes were due in large part to the addition of SABIC EuroPetrochemicals' production and sales in the first half of 2003.

## **RATINGS**

### **Fitch Upgrades Rating On Ahli United Bank London Subsidiary To B/C**

Ratings agency Fitch has upgraded its individual support rating on the London subsidiary of Bahrain's Ahli United Bank (AUB) – Ahli United Bank (UK) Plc (AUBUK) – to B/C from C. The upgrade is the result of an improvement in the bank's risk profile, cost culture and ability to sustain revenue growth. Fitch kept AUBUK's main long-term credit rating at BBB+. AUB posted a profit of \$59.7mn in 2002 (*MEES*, 23 June) and raised its share capital to \$650mn at the end of that year (*MEES*, 6 January).

## **AID**

### **AFESD Gives Syria \$73Mn Loan For Power Project**

The Arab Fund for Economic and Social Development (AFESD) has agreed a loan worth KD22mn (\$73.3mn) with Syria to help finance a power project in Zayzun. The loan has a maturity of 22 years, including a four-year grace period, and carries an interest rate of 4.5%. The aim of the project is to help meet increased electricity demand by converting the electricity power station in Zayzun into a combined cycle plant, thereby raising its power generation capacity. The project, which will also help to protect the environment, will include mechanical and electrical works, technical services and administrative support. The loan brings total AFESD lending to Syria to KD536mn (\$1.79bn).

### **EIB Gives Jordan \$45Mn Loan For Educational Reform**

The European Investment Bank (EIB) on 17 July announced a \$45mn long-term loan in support of the educational component of the Jordan's 2003-08 "Plan for Social and Economic Transformation" (PSET). The project will establish 160 new schools, including 140 classrooms for pre-school education, 800 extensions and the rehabilitation of 340 existing buildings. Also upgraded will be schools' IT facilities in an effort to boost skills and reduce unemployment. The project is being cofinanced by the Jordanian Government, the EIB and the World Bank, and grants from development agencies such as the Arab Fund for Economic and Social Development (AFESD) which made a contribution of KD10mn (\$33.4mn) in June (*MEES*, 30 June).

### **IMF Completes First Review Of Jordan's Stand-By Arrangement**

The IMF on 11 July announced the completion of the first review of Jordan's performance under a two-year 85.3mn standard drawing rights (SDR – approximately \$119mn) Stand-By Arrangement, approved on 3 July, 2002. With the review complete, Jordan is entitled to the release of a further SDR21.3mn (about \$30mn), bringing the total amount available under the program to SDR32mn (about \$45mn), said the IMF. However, in view of the country's current strong external position, the government has decided not to draw the available financing. IMF Deputy Managing Director, Anne Krueger, said that "the Jordanian economy performed strongly through 2002, despite the difficult regional environment, and the authorities should be commended for their commitment to sound macroeconomic policies and far-reaching structural reforms." The impact of the war has been mitigated, she noted, by the authorities' economic management and international donor support.

### **US Grant Of \$20Mn To Palestinians**

The US has granted the Palestinian Authority (PA) \$20mn under an agreement signed on 16 July by the USAID regional director Larry Garber and Palestinian Finance Minister Salam Fayyad. The grant, which is seen to strengthen the hand of Palestinian Prime Minister Mahmud 'Abbas in a new peace process with Israel, will be used to restore and improve basic services in Palestinian arrears vacated by Israeli military forces under the US-backed "road map".

## *The Political Scene*

*The death of ex-president Saddam Husain's two sons grabbed the headlines, but it was unclear what the practical consequences of this development might be. As the US casts about for international help in Iraq, the UN Special Representative for Iraq has been briefing the Security Council on the situation there. President Bush has excoriated Syria and Iran for supporting terrorism, and the EU has linked the development of its relations with Tehran to, inter alia, the Iranians' cooperation with the IAEA.*

### **Exit 'Uday And Qusay**

The death of former Iraqi president Saddam Husain's two sons, 'Uday and Qusay, in a firefight with US forces in Mosul on 23 July was undoubtedly a blow for however many supporters of the ex-president there remain in Iraq. As President George Bush put it on the next day, "now more than ever all Iraqis can know that the former regime is gone and will not be coming back." (However, this deterrent effect is to some extent offset by the Americans' all-or-nothing approach to eradicating the Ba'th party, which may be driving moderate Ba'this into the Saddamist camp.) Whether it is a famous victory for the American campaign to end the low-intensity guerrilla war against coalition forces is far less clear and would seem to depend on who is behind the attacks. The currently popular theory is that it is a mixture of Saddamists and Islamists. To the extent that it is the former, the removal of 'Uday and Qusay from the scene will presumably discourage the attackers. To the extent it is the latter, it presumably will not. In the immediate aftermath of the gunfight in Mosul it was pretty much business as usual, with further attacks on US forces near the city on 23 and 24 July. But it is early days yet, and the true impact of events in Mosul – if any – will only become apparent in the longer run.

### **Iraqis Want Self-Rule, Security And Services, Says UN's De Mello**

In the fullness of time, it may also emerge whether the Americans had any realistic plans for post-war Iraq before they invaded and occupied the country. But whatever these may (or may not) have been, the task of first stabilizing Iraq and then reconstructing it politically and economically is turning out to be so enormous that Washington has started casting about for military and financial help from the rest of the international community. (Other countries might be sorely tempted to point out that since the US ignored their objections before invading, they were under no legal or moral obligation to help extricate the Americans from a situation of their own making. But the fact is that Iraq is a mess that concerns everyone, and other countries may have little choice but to pitch in and help.) At present the Americans are soliciting this help on a bilateral basis and under the control of the Coalition Provisional Authority (CPA). But countries such as Russia, Germany, India and France (in particular) want a new mandate from the UN first and a real role for the UN in the stabilization and reconstruction of Iraq. French Foreign Minister Dominique de Villepin expressed the views of this school of thought in a radio interview on 24 July, saying that "patching up a system on the basis of what exists now, adding foreign forces to the coalition forces does not seem to us to be the best way to ensure Iraq's security." He went on to argue that "we must put the UN at the heart of it. Only the UN can provide the security guarantees that are needed to allow the entire (international) community to work together." Mr de Villepin called for this to be done through a modified version of resolution 1483, saying "we must lay out clearly the UN mandate and set the UN's task with respect to both the political outlook and to those conditions of transparency which would allow the international community to intervene more actively on the economic and financial fronts. And on the security front, it must be a real peacekeeping force."

The Iraqis too would like to see the UN playing a major role in their country, according to the UN Secretary-General's Special Representative for Iraq, Sergio Vieira de Mello, who told the Security Council on 22 July that the people of Iraq are seeking "an energetic, center-stage role" for the UN. Mr de Mello, who was briefing the Security Council as an introduction to the Secretary-General's report on the implementation of Security Council resolution 1483, (for excerpts of the report see pages D1-7) said that in his discussions with Iraqis "a number of consistent themes emerge." First, the Iraqis "want to see themselves back at the helm of their country. They also want to see the arrival of security and the rule of law. Equally, Iraqis want to see the restoration of basic services." The UN official welcomed the formation on 13 July of Iraq's Governing Council as "a significant step" towards the goal of establishing Iraqi self-rule.

On the question of restoring law and order and security, the UN Special Representative said the coalition powers had the primary obligation to act, adding that “ultimately only Iraqis can perform the responsibility, on behalf of a national authority that enjoys credibility, respect and resources. Though we cannot, nor wish to, be a substitute for the CPA in this field, the UN stands ready to lend modest assistance.”

Turning to the oil-for-food program, Mr de Mello said that given its sheer scale, achieving completion by 21 November was always going to be a challenge. Nevertheless, “with a coordinated and determined effort on all sides it should prove possible. But needs will continue to exist far beyond the handover of the program, until the economy picks up and reliance on humanitarian assistance declines. In the centre and south, good cooperation has been established between the CPA, the Iraqi ministries and relevant UN agencies. Work is well under way on the prioritizing of contracts. It should be noted, however, that the number of contracts being adopted is much higher than initially envisaged because the humanitarian phase has been superseded by rehabilitation and recovery activities more quickly than anticipated.”

Looking ahead to the task of reconstruction, Mr de Mello noted that the needs were immense in the short and longer terms, “not only as a consequence of the conflict but maybe more as a consequence of 13 years of sanctions and neglect and decay. As reflected in 1483, this reconstruction is not only of a physical nature but also must include public administration, governance, civil society and all the other vital elements required for a new Iraqi society.”

### **Bush Attacks Syria And Iran: Tehran Under Pressure From EU**

If anyone was under the impression that Washington’s recent silence on the subject of Iran and Syria betokened some softening of the Americans’ hostility towards these particular *betes noires*, President Bush made it clear on 21 July that this was not the case. Speaking at his ranch in Texas, Mr Bush called on all governments in the Middle East to support the Israeli-Palestinian peace process, adding: “This includes the governments of Syria and Iran. Their behavior is – today, Syria and Iran continue to harbor and assist terrorists. This behavior is completely unacceptable and states that support terror will be held accountable. Supporting and harboring terrorists undermines the prospects for peace in the Middle East, and betrays the true interests of the Palestinian people. Terrorism is the greatest obstacle to the emergence of a Palestinian state. And all leaders who seek this goal have an obligation to back up their words in real actions against terror. And leaders who are interested in a peaceful solution in the Middle East must support the efforts of Prime Minister 'Abbas to build a democratic Palestine and ease the hardships faced by the Palestinian people.”

Iran is also coming under pressure from the EU, which appeared to move a step in the direction wanted by the Americans (and the Israelis) in a joint declaration issued by the EU foreign ministers in Brussels on 21 July demanding the “urgent and unconditional acceptance” by Tehran of an additional protocol under the nuclear Non-Proliferation Treaty (NPT). The declaration said that the EU expected Iran to “show full transparency and cooperate fully with the International Atomic Energy Agency” and that “progress in economic and political relations with Iran should be evaluated in parallel.” And for good measure, it added that “more intense economic relations can be achieved only if progress is reached in the four areas of concern, namely human rights, terrorism, non-proliferation and the Middle East peace process.”

Charles Snow

## *Middle East Document*

### ***Disenchantment With US Iraq Policy***

*In the following article, published in the Toronto Globe and Mail on 18 July, Isam al-Khafaji – a professor of political economy at the University of Amsterdam – explained his reasons for resigning from the US's Iraqi Reconstruction and Development Council in Baghdad.*

On July 9, with deep sorrow, I respectfully submitted my resignation as a member of the Iraqi Reconstruction and Development Council to US Deputy Secretary of Defense Paul Wolfowitz.

I did this with great sadness but, in doing so, I was able to leave Iraq with a clear conscience. If I stayed any longer, I might not be able to say that. I feared my role with the reconstruction council was sliding from what I had originally envisioned – working with allies in a democratic fashion – to collaborating with occupying forces.

I had returned to Baghdad in May, just a few weeks after the fall of Saddam Husain, with much hope after 25 years in exile from my country. It was one of the most difficult decisions of my life to accept the invitation of the US government to return to Iraq with more than 140 other Iraqis as part of this council to help with the post-war reconstruction and rehabilitation of ministries so that Iraq could eventually be turned over to a transitional government.

My understanding of this council, which first reported to Jay Garner, the retired US general, and now to civil administrator Paul Bremer, was that it would work with Iraq's ministries, not as ministers but, in the background, as advisers. Its goal was to restore Iraq's badly damaged infrastructure – the electricity, the hospitals, the water supplies and the transportation routes – at least to its pre-war state so that the country could be turned over to a transitional government. Though we council members came from all over the world, we all are Iraqis. Many of us have been exiled for many years, but we still consider ourselves Iraqis. When you keep in touch with what is going on in your country, it is not a big deal whether you are outside.

I accepted the fact that we were a defeated country, and I had no problem working with the US to pull my country out of a quagmire. But there seemed to be no interest on the part of the coalition in involving Iraqis as advisers on the future of their country. Our role was very limited. Even reporters who visited us took note, writing that although the reconstruction council has an office within the presidential palace, there seems to be little done there apart from members reading their e-mail – certainly a luxury in post-war Baghdad.

There was so much euphoria when Baghdad first fell, but the Americans came in and acted with arrogance. While many Iraqis are relieved to see Saddam out of power, and accept the fact that the US is the only power that can secure some semblance of order, they now see the US acting as an occupier. Sadly, the vision for a transitional government and democratic elections, put forward by Mr Wolfowitz seems to have been forgotten in the everyday pressures of post-war Iraq. Mr Wolfowitz is a visionary, but he has not done the work to see the concrete application of his vision. He said he wanted to help bring democracy to Iraq and many of us thought we should support him because we too want to see democracy in Iraq. In practice, however, he is just one player – albeit a big player – and there are many others on the ground in Iraq who do not share his vision. Many reports have noted that even the soldiers here bluntly say they take their orders from their general, not from Mr Bremer.

Bitter disputes between the Defense Department and the State Department, which were evident even before the war began and duly reported in the US press, continue to affect the situation. Even though Mr Bremer has the formal authority within Iraq, it seems like each and every decision must go back to Washington, and we are the victims of indecision.

Iraq is now in almost total chaos. No one knows what is going on. We're not talking here about trying to achieve an ideal political system. People cannot understand why a superpower that can amass all that military might can't get the electricity turned back on. Iraqis are now contrasting Saddam's ability to bring back power after the war in 1991 to the apparent inability of the US to do so now. There are all kinds of conspiracy theories. Many wonder if the US has a reason for not wanting the electricity back on. Now Mr. Bremer has established the Iraqi Governing Council. Sitting together to consider the future of Iraq are 25 representatives, hand-picked by the US-led coalition. The composition is not a bad one, but few of the members have substantial domestic constituencies. (The exception is the Kurds whose parties have been active among their people since the 1991 Gulf War.) Whether the Council is effective or not depends on whether its members are able to reach any consensus. I fear they will be played against one another. To succeed, they must take a unified position on issues and tell Mr. Bremer to go to Washington and say "this is what Iraqis want, now please give your support for that."

Ultimately, the Council must be prepared to say: "give us full authority and we will ask for your advice when we need it."

I am thus far, the first and only member of the reconstruction council to resign. There may be others, though many will no doubt stay and hope for the best.

For my part, I remain optimistic for my country, at least in the medium term. When I think about the Iraqi people, how strong they are, how hard they work without complaining under summertime temperatures reaching 55° C. I feel there is much left within these people of Iraq. There are many signs that Iraqis are working together, without serious tensions between ethnicities. All this is good news for a future Iraq. In the short term however, I fear there will be more conflicts run through with both Iraqi and American blood.

I hope the day will come when I will return to Iraq. I miss it already.

## ***First UN Report On Post-Saddam Iraq***

*The following are excerpts from the first UN Secretary-General report on Iraq, prepared by Special Representative for Iraq, Sergio Vieira de Mello, in accordance with Security Council resolution 1483 and presented to the Council on 17 July. For full text of the report, see:*

*<http://ods-dds-ny.un.org/doc/undoc/gen/n03/430/63/pdf/n0343063>*

### **III. Political Transition Process**

15. In accordance with the mission's mandate as set out in paragraphs 8 (c) and 9 of resolution 1483 (2003), my Special Representative has sought to define how best<sup>4</sup> the United Nations might contribute to the political process — which had already begun prior to his arrival. My Special Representative sought first to elicit the views of as broad a range of Iraqis as possible on the Authority's transitional plans to create a political body and a constitutional framework.
16. After decades of repressive rule, there is a democratic deficit in Iraq, which needs legitimate institutions. Indeed, political life based on pluralism is having to be reinvented in Iraq. There is an urgent need for ethnic, sectarian, provincial and other components of society to unite into a single political community that is both respectful of the large cultural diversity of the Iraqi people and also open to new ideas that help individuals challenge traditional structures.
17. Many Iraqi leaders have indicated the urgency of all parties uniting behind a joint political program. This has led to efforts to open up to other parties the so-called Leadership Council, which comprised Abdel-Aziz al-Hakim (SCIRI), Iyad Allawi (INA), Massoud Barzani (KDP), Nasir al-Chadirchi (NDP), Ahmed Chalabi (INC), Ibrahim al-Jaafari (Da'wa) and Jalal Talabani (PUK). Despite the formation of dozens of political parties, a new Iraqi body politic remains in very embryonic form.
18. My Special Representative and his team have made efforts to meet with all of these groups, the newly emerging ones as well as those well established, whether formed by individuals who remained in the country or those who returned from exile. Their unanimous concern is the urgent establishment of an Iraqi provisional government, by an Iraqi process, which could help to address some of the immediate practical challenges currently faced in the country. For example, there is a marked difference between political life in northern Iraq and the rest of the country as a result of the past 12 years. This, in itself, has created concern among Iraqi Kurds that their achievements will be lost in the process of reintegration into the larger Iraqi national scene.
19. A common theme was that democracy should not be imposed from the outside; it had to come from within. Iraqi political, religious and civic leaders are currently reflecting on an Iraqi-led transition agenda. Some viewed the proposed creation of an interim Iraqi administration pragmatically — as a means to more effective administration in the short term and as a step on the road to the restoration of Iraqi sovereignty and ownership of the reform of key institutions and national policies that will shape the future of the country. Even though its powers would be limited, some believed that the very existence of an Iraqi interim administration would still make a difference.
20. A central concern in all my Special Representative's discussions was the constitutional process. Those Iraqis with whom my Special Representative has met have emphasized that Iraqis themselves must conduct the constitutional process and that an Iraqi interim authority should be in place before such a process is begun. Some Iraqi interlocutors strongly felt that participation in the constitutional process should be determined by elections. If requested, the international community, including the United Nations, can assist this process

by providing advice, lessons learned on different constitutional processes around the world, and technical assistance.

21. My Special Representative has facilitated communication between his Iraqi interlocutors and the Authority, while offering his own comments and suggestions. One of the main messages that my Special Representative has conveyed is the need to ensure Iraqi ownership of the political process and the tangible delegation of executive authority and real power to Iraqi representatives in terms of policy-making, including the allocation and administration of budgetary resources. While opinions have varied among Iraqis on the transitional formula, all emphasized the importance of a swift establishment, by Iraqis, of a provisional Iraqi government, with real authority for its interim ministers.
22. The Coalition Provisional Authority has deployed intensive efforts to build consensus around its evolving transition plan, initially by expanding its consultations from the original seven-party Leadership Council to a group of 15 to 17 political figures, tribal leaders, religious figures, independent personalities, and representatives of civil society and human rights and women's groups. Over the past few weeks, the Authority's political transitional plan has evolved rapidly, with the idea of establishing a self-selecting and broadly representative Governing Council.
23. The importance for the Iraqi people of moving quickly towards their own government cannot be overstated, not least in terms of getting the constitutional process off to a good start. My Special Representative, therefore, has strongly advocated that the Authority devolve real executive authority to a broadly representative and self-selecting Iraqi leadership, including in policy- and decision-making, and in the preparation and execution of a budget. This advice was favorably received by the Authority.
24. I welcomed the establishment of the Governing Council on 13 July. An agreed document (between the Authority and Council members) states that "The Governing Council is the principal body of the interim administration of Iraq called for in Security Council resolution 1483 (2003)." The 25-member Governing Council, which includes three women, has a slight Shi'ah majority and an equal representation of Kurds and Sunnis. There are in addition representatives of Christians and Turkmen. The Governing Council will name an interim minister for each ministry and will have the right to set policies and take decisions, in cooperation with the Authority, and designate international representation during the interim period. In the finance area, the Governing Council, together with representatives of IMF, the World Bank and UNDP, will play a full part in drawing up the national budget for 2004, which will be subject to its approval. In addition, it will have the right to consider substantial amendments to the emergency budget for 2003. The Governing Council will consider appointing a preparatory constitutional commission to recommend to it a process by which a new constitution for Iraq will be prepared and approved.
25. In an effort to move forward the process of defining the key elements of this part of the transition process, my Special Representative convened an initial meeting with Iraqi experts and the Authority on 1 July to begin sharing experiences and to ask Iraqis how they envisage the constitutional and electoral processes developing, on the basis of traditional Iraqi values, the best interests of the country and democratic principles.
26. According to the Coalition Provisional Authority, the full restoration of sovereignty will come after the drafting of a new constitution and the holding of national elections. In discussions with the Authority, my Special Representative has proposed that voter registration should begin in the near future to demonstrate that tangible steps are being taken to pave the way for elections. To that end, I have instructed the Electoral Assistance Division of the Department of Political Affairs, as a matter of urgency, to send an assessment mission to Iraq to discuss with relevant Iraqi and Authority counterparts the various possible modalities for

electoral registration and the electoral process, including electoral laws, rules and regulations, registering political parties, and options for United Nations electoral support in those areas.

27. Although Iraqi views diverge on how quickly conditions will allow for truly participatory and representative processes, there is a widely held perception that the forthcoming constitutional and electoral processes will be of fundamental importance to the political transition envisaged in paragraph 8 (c) of resolution 1483 (2003). It is in these areas — the scope of which is yet to be defined with Iraqi experts — that I believe the United Nations can make a significant contribution. Not only can United Nations involvement confer legitimacy on the process, it can also put at the disposal of the Iraqi people the wealth of experience and expertise accrued by the United Nations in these fields over the years, including advice on meaningful human rights provisions and protection mechanisms. To this end, we stand ready to assist the Governing Council, including the provision of technical support to a secretariat for the Governing Council, at its request.

### **VIII. Oil-For-Food Program**

74. The completion of the oil-for-food program as prescribed in Security Council resolution 1483 (2003) involves two distinct sets of actions. While procedural changes are envisioned in the central and southern governorates in the three northern governorates, the transfer of responsibility will involve substantive activities.
75. On 21 June, my Special Representative wrote to the Administrator stating the United Nations understanding of our mutual and individual obligations, in the context of resolution 1483 (2003) regarding the orderly transfer of the oil-for-food program to the Coalition Provisional Authority. The Authority's response stressed that its understanding of resolution 1483 (2003) with regard to the respective responsibilities vis-à-vis the transition of the oil-for-food program was consistent with that of the United Nations.
76. In relation to the centre and south, the Authority has been fully engaged and, together with the appropriate Iraqi technical personnel, the prioritization of applications is progressing. Regular meetings at a technical level involving the Authority, civil servants from the Iraqi "ministries" and the United Nations have been held. The restriction on staff freely returning to Iraq as a consequence of the uncertain security environment is having an impact on the speed with which these tasks can be undertaken.
77. The United Nations, in concert with the Authority, has commenced a review of the applications that have been prioritized to date and sought to verify that the requisite procedures established by the Office of the Iraq Program have been fully respected and that the process is transparent. All parties are confident that the review of approved and funded applications will be completed prior to cessation of the program in November 2003.
78. United Nations planning is at an advanced stage and liaison with the Authority vis-à-vis the transfer of the program in the three northern governorates has been initiated. In addressing the transfer, two broad areas have been identified, namely the handover of fixed and mobile assets, and the transfer of contractual obligations. The Authority has agreed to a United Nations proposal to establish a high-level tripartite working group to include the United Nations, the Authority and the local authorities of the three northern governorates which will guide the transition effort. 79. The transfer of assets, while labor-intensive, appears to be a matter that presents few complications. Most of the moveable assets are already covered by a loan agreement in one form or another. The registration of these assets and the preparation of transfer documents will be time-consuming. However the transfer of assets to the local authorities undertaken in preparation for the United Nations relocation in March will form a sound basis on which to pass on ownership.

80. The situation regarding the transfer of projects that are covered by ongoing contracts is a greater challenge. I believe that we need to consider each of these cases on its individual merits. Further, there would seem to be only three options available to the Authority in considering these cases: pay out the remaining contractual penalties or contract costs and not proceed further; simply leave the project unfinished; or continue the project until completion.
81. In approaching the last of these options, neither myself nor my Special Representative consider the continued involvement of the United Nations beyond 21 November 2003 in the management or execution of projects as being the right option in any but a very small number of unique cases.
82. During discussions with my Special Representative and his staff, representatives of the Authority have voiced their desire for the continuation of projects that would have commenced, had the program not been suspended in March. Accordingly, implementation will proceed for those projects in the three northern governorates that were at an advanced stage of contracting at the time of my suspending the program, with the caveat that, prior to the project being reinstated, a comprehensive strategy for transfer of implementation to the Authority by 21 November and for the end of the United Nations involvement must be jointly agreed by my Special Representative, the Authority and the future Iraqi interim administration.

## **X. The Way Forward**

### **A. Approach**

95. In resolution 1483 (2003) the Security Council conferred on the United Nations a broad mandate, in a wide range of critical activities and in a unique set of circumstances. It authorized the Organization to facilitate dialogue and consensus-building among Iraqis in various sectors of activity. The challenge for the United Nations in Iraq is to find meaningful and effective ways to assist the Iraqi people in achieving their goals. Its aim is to help them participate in, and take ownership of, the definition of the policies and priorities that will shape the future of their country.

96. I have come to the firm conclusion that the United Nations can begin to assist the Iraqi people now in making a difference. It has already begun to do so, particularly in helping to pave the way for the restoration of sovereignty to democratic Iraqi institutions, on the basis of rule of law. It has provided the requisite space and an impartial forum in which Iraqis can conduct their deliberations. The United Nations is making available to Iraqi groups, and the Authority, factual information about how certain issues have been tackled in post-conflict situations, and lessons learned, especially in ensuring participatory processes and local empowerment. Ultimately, the United Nations, as mandated in resolution 1483 (2003), is a resource at the disposal of the Iraqi people, whose interests are at the forefront of all our work.

97. Iraq is rich in human resources. Critical from the outset is placing qualified Iraqis in the lead in the planning and management of Iraq's recovery. I endorse the approach taken by my Special Representative, which is based on the twin principles of inclusiveness and empowerment of the Iraqi people, and has capacity-building as its natural corollary.

### **B. Tasks**

98. Having listened carefully to the requests of those Iraqis with whom my Special Representative has met and consistent with the provisions of resolution 1483 (2003), the focus of United Nations action in Iraq, for the remainder of 2003 only, will include the following:

- (a) Delivering humanitarian assistance, promoting the safe, orderly and voluntary return of refugees and displaced persons, and conducting emergency rehabilitation as set out in the revised humanitarian appeal of 23 June;
- (b) Engaging in the facilitation of national dialogue and consensus-building on the political transition process;
- (c) Assisting in the establishment of electoral processes;
- (d) Promoting the protection of human rights through:
  - (i) Observing and analyzing the prevailing human rights situation in the country;
  - (ii) Encouraging the development of a national human rights action plan;
  - (iii) Promoting the establishment of an independent national human rights institution;
  - (iv) Engaging and supporting national dialogue and institutions to address accountability for past human rights violations;
  - (v) Promoting human rights education through the establishment, together with UNDP, of a Human Rights Documentation and Training Centre in Baghdad;
  - (vi) Advising on training curricula, and conducting training for civil servants — law enforcement and judicial personnel in particular — in the area of human rights and gender, consistent with human rights and related instruments to which Iraq is already a party;
  - (vii) Supporting the development of civil society, particularly Iraqi human rights and women's groups, legal associations and free and independent media;
- (e) Implementing, through UNDP, two concrete projects relating to the emergency rehabilitation of the courts and support for the Judicial Training Centre in Baghdad;
- (f) Establishing an Iraqi Media Centre;
- (g) Ensuring the orderly phasing out of the oil-for-food program by 21 November 2003;
- (h) Contributing, through UNDP and the international financial institutions, to assessing potential needs for economic reconstruction and sustainable development;
- (i) Sharing United Nations experiences and lessons-learned with Iraqis, and the Coalition Provisional Authority, on post-conflict processes in general, as requested;
- (j) Assisting the Iraqi interim administration to gradually rejoin the international community, particularly in those intergovernmental forums in which the United Nations has especial competence and expertise. 99. Bearing in mind the provisions of resolution 1483 (2003), my Special Representative will discuss, whether, when and how the United Nations considerable experience in the following areas — which is not an exhaustive list — could be of added value:
  - (a) Electoral processes;

- (b) Constitutional processes;
- (c) Judicial and legal reform;
- (d) Police training and restructuring and reform of correctional systems;
- (e) Demobilization and reintegration of former soldiers;
- (f) Public administration and civil service reform;
- (g) Institution of long-term strategies for economic reconstruction, sustainable development and good governance;
- (h) Technical assistance and advisory services to Iraqi ministries.

### **C. Structure**

100. The proposed United Nations Assistance Mission for Iraq (UNAMI) will consist of the Office of the Special Representative; the Office of the Deputy Special Representative of the Secretary-General and Resident Humanitarian Coordinator; an Office of the Chief of Staff, including a Policy and Planning Office, and a Translation Unit; a Political Affairs Office; a Human Rights and Rule of Law Office; a Legal Office; and a Public Information and Media Development Office. A Humanitarian Affairs Office will be functionally attached to the Office of the Special Representative; this will, however, remain a part of the Office for the Coordination of Humanitarian Affairs until the end of 2003. Similarly, a World Bank representative and a member of IMF will be attached to the Office, but will retain the structural links to their parent bodies.
101. The Mission will be supported by a Division of Administration incorporating responsibilities for core administrative and logistic disciplines, as well as security and the administration of five regional offices.
102. In view of the broad range of responsibilities entrusted to my Special Representative, it is envisaged that the staff strength shall consist of over 300 civilian staff combined. This figure is inclusive of both substantive and support international and local personnel in Baghdad and each of the regions. This increase in staff strength is necessary (given the need to be administratively and logistically self-sustaining) in view of the liquidation of the Office of the Humanitarian Coordinator. The number of international staff would be less than half the total figure, as UNAMI will rely on a skilled Iraqi workforce, a number of whom would be employed as national professional officers. It would also be necessary to bring in relevant experts from United Nations Headquarters, or from outside, on short notice to provide advice, and share experiences with Iraqis and the Authority, as required. This arrangement could be employed for the exploratory work on electoral processes. However, an Electoral Unit would need to be created if the United Nations were given a more substantial role in this area.
103. This concept envisages maximum reliance on the existing capacity and structure of the Office of the Humanitarian Coordinator and on the Humanitarian Coordinator himself, Ramiro Lopes da Silva, whom I am concurrently appointing as the Resident Coordinator of the United Nations country team (of agencies, funds and programs) and my Deputy Special Representative for Iraq. He and his immediate personal staff would be included in the staffing of UNAMI. The rest of the Office, however, would continue to be structured and funded according to current arrangements until the phasing out of the oil-for-food program and the end of the period covered under the revised humanitarian appeal, on 21 November and 31 December 2003, respectively.

104. The emergency humanitarian phase is not expected to continue into 2004, when, it is hoped, developmental and reconstruction activities will commence. My Special Representative has been given a coordinating role in those areas also and will, therefore, still require an appropriate support structure.

#### **XI. Observations**

105. In his discussions, my Special Representative emphasized that an overriding goal of the United Nations — as expressed by the Security Council in resolution 1483 (2003) — was to support the right of the Iraqi people freely to determine their own political future and control their own natural resources. He conveyed to all concerned the Security Council's resolve that the day when Iraqis govern themselves must come quickly, and he has stressed the Security Council's call for a government based on the rule of law that affords equal rights and justice to all Iraqi citizens without regard to ethnicity, religion or gender. To this end, my Special Representative made clear the independence of his role and that the Coalition Provisional Authority, not the United Nations, was responsible for administering Iraq, for providing for the welfare of the people, and for restoring conditions of security and stability.

106. While the international community can lend assistance to Iraq, it is ultimately the people of Iraq who must build their own future. There has accordingly been an urgent need for an Iraqi body, widely accepted as representative, to be established so that the key issues facing Iraq can begin to be addressed by Iraqis themselves. To this end, my Special Representative has actively advocated the early formation of the Iraqi interim administration envisaged in resolution 1483 (2003) and has discussed with the Authority the best way of achieving that goal.

107. I welcome the recent establishment of the Governing Council. It will provide a broadly representative Iraqi partner with whom the United Nations and the international community at large can engage. If some of the concerns that have been relayed to my Special Representative in these initial weeks of his mandate are to be allayed, and the growing impatience is to be stemmed, it is important that Iraqis are able to see a clear timetable leading to the full restoration of sovereignty. There is a pressing need to set out a clear and specific sequence of events leading to the end of military occupation. My Special Representative stands ready to assist in the establishment of such a framework, working together with the Governing Council and the Authority.

108. The regional dimension is extremely important. Iraq cannot be treated in isolation from the region. I believe that an inclusive way of working with Iraq's neighbors will need to be found, as in the case of Afghanistan in 2002. My Special Representative intends to continue the contacts I initiated in Amman from 21 to 23 June 2003 and before long will have visited all of Iraq's neighbors.

109. Against this background, the aim of my report has been to provide the Security Council with an initial assessment of the scope of the challenges involved, and an indication of those areas in which I feel that the United Nations can play a useful role in view of its expertise and comparative advantage. In this regard, I have sought not to duplicate what the Authority or others may be doing and, above all, to keep foremost in mind the interests of the Iraqi people. Of paramount importance is the need to uphold the independent role of the United Nations, as set out in Security Council resolution 1483 (2003). The legitimacy and impartiality of the United Nations is a considerable asset in promoting the interests of the Iraqi people.

110. In conclusion, I wish to express my warm appreciation for the outstanding efforts of my Special Representative, Sergio Vieira de Mello, and all of his staff, and to pay tribute to the United Nations personnel in Iraq for the dedicated manner in which they have been carrying out their tasks in often difficult and trying circumstances.

## ***Iraq's Post-Conflict Reconstruction***

*The following is the Executive Summary of a report by a five-member Iraq Reconstruction Assessment Mission that visited the country from 16 June to 7 July at the request of Defense Secretary Donald Rumsfeld and the top US administrator in Iraq, Paul Bremer, to assess reconstruction efforts. The full text of the report can be found at <http://www.csis.org/isp/pcr/IraqTrip.pdf>.*

### **Executive Summary**

Rebuilding Iraq is an enormous task. Iraq is a large country with historic divisions, exacerbated by a brutal and corrupt regime. The country's 24mn people and its infrastructure and service delivery mechanisms have suffered decades of severe degradation and under-investment. Elements of the old regime engage in a campaign of sabotage and ongoing resistance, greatly magnifying the "natural" challenges of rebuilding Iraq. Given the daunting array of needs and challenges, and the national security imperative for the US to succeed in this endeavor, the US needs to be prepared to stay the course in Iraq for several years.

The next twelve months will be decisive; the next three months are crucial to turning around the security situation, which is volatile in key parts of the country. All players are watching closely to see how resolutely the coalition will handle this challenge. The Iraqi population has exceedingly high expectations, and the window for cooperation may close rapidly if they do not see progress on delivering security, basic services, opportunities for broad political involvement, and economic opportunity. The "hearts and minds" of key segments of the Sunni and Shi'a communities are in play and can be won, but only if the Coalition Provisional Authority (CPA) and new Iraqi authorities deliver in short order. To do so, the CPA will have to dramatically and expeditiously augment its operational capacity throughout the country, so that civilian-led rebuilding can proceed while there are still significant numbers of coalition forces in Iraq to provide maximum leverage over those who seek to thwart the process.

To succeed, the US and its allies will need to pursue a strategy over the next twelve months that:

- Recognizes the unique challenges in different parts of the country;
- Consolidates gains in those areas where things are going well;
- Wins hearts and minds even as it decisively confronts spoilers.

Seven major areas need immediate attention:

#### **1. The Coalition Must Establish Public Safety In All Parts Of The Country**

In addition to ongoing efforts, this will involve:

- Reviewing force composition and structure, as well as composite force levels (US, coalition, and Iraqi) so as to be able to address the need for increased street-level presence in key conflictive areas.
- Quickly hiring private security to help stand up and supervise a rapid expansion of the Iraqi Facility Protection Service, thereby freeing thousands of US troops from this duty.
- Ratcheting up efforts to recruit sufficient levels of international civilian police through all available channels; and, launching a major initiative to reintegrate "self-demobilized" Iraqi soldiers and local militias.

#### **2. Iraqi Ownership Of The Rebuilding Process Must Be Expanded At National, Provincial And Local Levels**

At the national level ensuring success of the newly formed Iraqi Governing Council is crucial. This will require avoiding overloading it with too many controversial issues too soon. The natural desire to draw away from the coalition by putting an Iraqi face on the most difficult decision must be balanced with a realistic assessment of what the council can successfully manage. At the provincial and local levels, coalition forces and the CPA have made great progress in establishing political councils throughout the country, but they need direction and the

ability to respond to local needs and demands. To achieve this, local and provincial political councils need to have access to resources and be linked to the national Iraqi Governing Council and the constitutional process.

### **3. Idle Hands Must Be Put To Work And Basic Economic And Social Services Provided Immediately To Avoid Exacerbating Political And Security Problems**

A model economy will not be created overnight out of Iraq's failed statist economic structures. Short-term public works projects are needed on a large scale to soak up sizable amounts of the available labor pool. Simultaneously, the CPA must get a large number of formerly state-owned enterprises up and running. Even if many of them are not competitive and may need to be privatized and downsized eventually, now is the time to get as many people back to work as possible. A massive micro-credit program in all provinces would help to spur wide-ranging economic activity, and help to empower key agents of change such as women. The CPA must also do whatever is necessary to immediately refurbish basic services, especially electricity, water and sanitation.

### **4. Decentralization Is Essential**

The job facing occupation and Iraqi authorities is too big to be handled exclusively by the central occupying authority and national Iraqi Governing Council. Implementation is lagging far behind needs and expectations in key areas, at least to some extent because of severely constrained CPA human resources at the provincial and local levels. This situation must be addressed immediately by decentralizing key functions of the CPA to the provincial level, thereby enhancing operational speed and effectiveness and allowing maximum empowerment of Iraqis. The CPA must rapidly recruit and field a much greater number of civilian experts to guide key governance, economic, social, justice and also some security components of the occupation.

### **5. The Coalition Must Facilitate A Profound Change In The Iraqi National Frame Of Mind – From Centralized Authority To Significant Freedoms, From Suspicion To Trust, From Skepticism To Hope**

This will require an intense and effective communications and marketing campaign, not the status quo. The CPA needs to win the confidence and support of the Iraqi people. Communication – between the CPA and the Iraqi people, and within the CPA itself – is insufficient so far. Drastic changes must be made to immediately improve the daily flow of practical information to the Iraqi people, principally through enhanced radio and TV programming. Iraqis need to hear about difficulties and successes from authoritative sources. Secondly, the CPA needs to gather information from Iraqis much more effectively – through a more robust civilian ground presence, “walk-in” centers for Iraqis staffed by Iraqis, and hiring a large number of Iraqi “animators” to carry and receive messages. Thirdly, information flow must be improved within the CPA itself through an integrated operations center that would extend across both the civilian and military sides of the CPA, and by enhancing cell-phone coverage and a system-wide email system that could ease the timely dissemination of information to all CPA personnel.

### **6. The US Needs To Quickly Mobilize A New Reconstruction Coalition That Is Significantly Broader Than The Coalition That Successfully Waged The War**

The scope of the challenges, the financial requirements, and rising anti-Americanism in parts of the country make necessary a new coalition that involves various international actors (including from countries and organizations that took no part in the original war coalition). The Council for International Cooperation at the CPA is a welcome innovation, but it must be dramatically expanded and supercharged if a new and inclusive coalition is to be built.

### **7. Money Must Be Significantly More Forthcoming And More Flexible**

Iraq will require significant outside support over the short- to medium-term. In addition to broadening the financial coalition to include a wider range of international actors, this means the President and Congress will need to budget and fully fund reconstruction costs through 2004. The CPA must be given rapid and flexible funding. “Business as usual” is not an option for operations in Iraq, nor can it be for the funding.

The enormity of the task ahead must not be underestimated. It requires that the entire effort be immediately turbo-charged – by making it more agile and flexible, and providing it with greater funding and personnel.