

# G.G.A. Note...

Global Growth Advisors - Global Strategic Consultancy Group

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## Assessing Risk in Saudi Arabia

*New Realities in Wake of the Arab Spring.*



## Introduction

Dear Readers,

Saudi Arabia is in a troubled state of mind as it faces new realities in the turbulent wake of the Arab Spring. Leaders in Riyadh were badly rattled by the spread of revolutionary sentiments. Events have confirmed their worst fears. In this report GGA Lead Advisor - Michael Brenner explains how pervasive Sunni-Shi'ite tensions and mutual suspicions are now entrenched as a marked feature of politics in the region.

These tensions demonstrate in concrete form that classic Realpolitik and the peculiar sectarian divisions at the very heart of Islam are intermingled and more virulent than ever. Less well recognized is that radical Islamist political organizations that promote their own independent agenda are themselves also seen as possible rivals to the Gulf monarchies – especially Saudi Arabia.

The report concludes that currently, a stakeholder in Saudi Arabia's economic outlook is well advised to keep an eye on political and economic factors.

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Saudi Arabia is in a troubled state of mind as it faces new realities in the turbulent wake of the Arab Spring. Leaders in Riyadh were badly rattled by the spread of revolutionary sentiments. Events have confirmed their worst fears. The critical moment came with the massive demonstrations of Bahrain's long subordinate Shi'ite majority directed against the ruling Sunni Khalifa clan in 2011. In Saudi eyes, it raised the specter of sectarian, secular democratic and external forces coming together to pose a direct threat to their own rule. Although no evidence has come forth to credit Saudi and Bahraini claims of Iran's role in provoking the demonstrations, the strong perception was of a multifaceted, mortal challenge. For the Saudis, Bahrain was a proxy war of enormous importance for their own interests. Hence, the House of Saud moved to suppress it by lobbying strongly against the making of concessions, and then by sending in their own military to suppress it forcibly.

## Background and Context

Pervasive Sunni-Shi'ite tensions and mutual suspicions are now entrenched as a marked feature of politics in the region. They demonstrate in concrete form that classic Realpolitik and the peculiar sectarian divisions at the very heart of Islam are intermingled and more virulent than ever. Less well recognized is that radical Islamist political organizations that promote their own independent agenda are themselves also seen as possible rivals to the Gulf monarchies – especially Saudi Arabia.

The House of Saud remains steadfast in affirming its position as the custodian of strict Sunni theology and practice that accompanies its role as defender of the Holy Places. The forces of change sweeping the Middle East have made them all the keener to secure the Kingdom's unique status in the world of Islam. Saudi leaders are sensitive to the fact that their legitimacy is vulnerable to challenges that they seized the Hejaz by force in the 1920s during the dissonance following the disintegration of Ottoman rule. It is manifest in its instinctively aggressive campaign against any Salafist movement that claims to be a cynosure of an even truer orthodoxy. Saudi leaders observe the categorical imperative that their survival dictates preventing at any cost anyone to outflank them on the fundamentalist end of the Islamist continuum.

Divergent attitudes exist among senior members of the ruling family – on matters of religious observance as well as on policy. What they share is the dedication to wahhabism as the keystone of their rule. The country's religious establishment, for their part, have blessed the House of Saud's rule, stand clear of politics, and are reciprocated with an almost free hand on religious matters.

One should beware of regarding the House of Saud as a monolith. It is essentially a tribal structure; its head represents the tribe, but needs to carry along the other clan heads etc in decisions. This leaves a lot of leeway for tribal bigwigs to pursue their own policies; Therefore, one should not be surprised if some of them are actually (financially) supporting Jihadis such as AQ and other salafist groups (as probably do some Wahhabi religious leaders) – even when it contravenes national policy.

The Saudi royal family must always be attentive to burnishing their credentials among Sunnis as the purest of the pure. The requirements for do so vary according to circumstance. Settled times favor them. Unsettled times, particularly in regard to the upwelling of Sunni fundamentalism, can pose competition. Presenting themselves as champions of the Sunni cause against the Shia as championed by Iran may serve this purpose; however, it carries the risk of raising the fever among the very Salafist Sunni groups who could become a mortal threat of a kind that Iran does not. Al-Nusra and ISIS in Syria are current examples. Its joining of a Taliban-like doctrine with aspirations to reestablish the Caliphate makes it doubly dangerous.

Is it not a mistake, therefore, for the Saudi leaders to inflate the Iranian military threat as symbolized by its potential nuclear capacity? Objectively, they should have little to worry about on this score given the dominant American military presence in the region. There enters is the credibility and confidence factor. President Obama

is not considered reliable. His vacillating behavior on air strikes in Syria confirmed suspicions that he is a weak leader inclined to follow the course of least resistance. That disposition is reinforced by a seeming desire to go down as the “peace president.” That impression will endure.

## Practical Policy Implications

It is imperative that the Saudi regime continue to mute domestic discontents through heavy spending on social programs and subsidies to the general population. Since the outbreak of the Arab Spring, these expenditures have grown to approximately \$28 billion per annum. They have covered that commitment thanks to the consistently high price of crude oil on international markets combined with increased exports facilitated by the sanctions on Iranian oil. The latter factor is already changing as progress in the 5 + 1 nuclear talks has led to an easing of the terms of the international boycott. Saudi authorities have set \$90 per barrel as the minimum that they for generating the necessary revenues in the future.

Projections of the International Energy Agency for see the price of oil stabilizing within the \$90 – 115 range for the foreseeable future (roughly twenty years) albeit inevitable short-term spikes and dips might occur.

Saudi Arabia owns hard currency reserves of about \$550 billion. They could be tapped in the event that earnings from oil exports go down due to a sharper than predicted decline in the market price for oil. If such a decline were prolonged, authorities would face the choice of either drawing down its reserve holdings or taking the risks of social instability as might result from a marked reduction in social spending.

Therefore, the most worrisome scenario for Saudi policy-makers is prolonged slowdown in the global economy. The long recession that has been experienced in Europe and North America since the financial crash of 2008 demonstrates that there is no assurance of the developed world’s ability to master macro-economic management. Indeed, the attachment to failed austerity grounded policies is a primary reason for the stagnation of the past five years that continues with no sign of giving way to robust growth. If the event that a Japan-like lost decade of minimal growth were to be repeated for a the largest slice of the world’s developed economy, the effects on aggregate energy demand would be substantial – shifting the terms of the demand-and-supply equation. That would mean lower prices for crude oil, lower exports, and substantially lower aggregate hard currency earnings for Saudi Arabia.

The reasons why this low growth scenario has a measure of credibility include: a systemic inadequacy of demand expansion (particularly important, relative to supply) due to a continuing process of deleveraging, regressive fiscal policies, stagnation in the incomes of salaried workers, and static or declining populations with associated shifts in the age demographics.

The critical role played by oil revenues, vulnerable to uncontrollable market shifts, create incentives to expand the hard currency earning petro-chemical sector of the Saudi economy. Moving downstream has been an objective of Saudi planners for decades which has registered some success. There is a good likelihood that the strategy will be accelerated and strengthened.

## Tell-Tale Signs

A stakeholder in Saudi Arabia’s economic outlook is well advised to keep an eye on these factors.

### Political

- The succession to the ageing and ailing King Abdullah. In addition to the rival personalities, the important consideration is the Kingdom’s ability to retain a solidarity of outlook among the leadership. In a period of uncertainty that bring difficult decisions in its train, there is a danger of fissures that could

lead to indecisiveness and/or vacillating policies.

- The outcome of the nuclear talks with Iran. Their breakdown would heighten tensions around the Persian Gulf. Military conflict, or even prolonged confrontation, carries the threat of disruption in oil exports and the intensification of salafist political elements which have the Saudi regime in their sights.
- The tenor of relations between the Saudis and the United States. The increased strains of recent months have introduced in a new factor of instability whose exacerbation or easing affects the entire picture.

### *Economic*

- Trends on the supply side of the oil market equation that impinge on the level of Saudi oil exports as well as prices.
- Growth rates in Asian economies, currently declining, that are the biggest factor on the demand side of the equation.
- Indications of renewed instability on international financial markets.

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### **About G.G.A.**

G.G.A. is a strategic consulting firm and the leading advisor on business strategy. We partner with clients from the private, public, and not-for-profit sectors in all regions to identify their highest-value opportunities, address their most critical challenges, and transform their enterprises. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 2010, G.G.A. is a private company with locations in more than 20 countries. We seek to be agents of change—for our clients, our people, and society overall.