



The Cambridge Security Initiative

REPORT ON SAUDI ARABIA

JULY 2019

POLITICAL STABILITY

Rumours about who is calling the shots in Riyadh have circulated since King Salman bin Abdulaziz ascended the throne in January 2015, and almost immediately began to bestow power on his son Mohammed Bin Salman (MBS). In his early 30s, MBS has attempted to cast himself as a reformer, promoting economic and social changes within Saudi Arabia that were long overdue. However, his behaviour consistently reveals the nature of a tyrant, one with little regard for human rights or the rule of law. Witness his treatment of dissenting voices within Saudi Arabia; his over-reactions to external criticism as evidenced by both diplomatic tantrums (the embargo against Qatar, the 2018 expulsion of the Canadian Ambassador) and the murder of journalist Jamal al-Khashoggi at the Saudi consulate in Turkey; and the way the Saudi-led war in Yemen has been prosecuted. His pursuit of power has frequently been brutal, and several of his foreign policy efforts have failed to meet their stated or perceived objectives; however, this should not be confused with recklessness. MBS has taken consistent, strategic steps toward securing his powerbase within Saudi Arabia and to cement Saudi Arabia's key partnerships abroad, using both carrots and sticks. Though currents of discontent are troubling Riyadh's relationships with both Washington and London as of mid-2019, the Iranian threat that has erupted at this critical juncture will likely be sufficient to ensure continued political and military support from both the United States and the United Kingdom.

MBS has a close relationship with Abu Dhabi Crown Prince Sheikh Muhammad bin Zayed, the de facto ruler of the United Arab Emirates, whom some have speculated is like a mentor to MBS. This strategic alliance enables both nations to leverage each other's strengths, but also help hide each other's hands. For example, Saudi Arabia and the UAE have together formed the backbone of the coalition ostensibly fighting on behalf of the ousted democratically-elected Yemeni government since 2015. Together, they led the embargo against Qatar, with officials from the UAE frequently making the most noise. However, daylight has begun to show between the two leaders' foreign policies. The UAE has been careful to keep from antagonizing Iran outright in the latest verbal battles being fought across the Persian Gulf following attacks on oil tankers off the UAE. Further, Abu Dhabi recently announced it is drawing down from the Yemen conflict, handing strategic ports over to Saudi soldiers. MBZ's decision to distance his foreign policy goals from MBS' is likely a reflection of shifting internal power dynamics within the UAE and not a sign of a break between the two leaders. While MBS is likely stung by the UAE's withdrawal of lock-step support, he will likely simply lean more heavily on his relationships with Washington and London to achieve his regional goals.

MBS has worked to cultivate a close relationship with Trump administration insiders, particularly President Trump's son-in-law Jared Kushner. As a result, U.S. support for Saudi Arabia is likely to continue as long as Trump retains the Presidency, since U.S. congressional attempts to halt U.S. engagement in the Saudi-led war in Yemen are unlikely to gain sufficient traction in the partisan atmosphere to rise to the two-thirds majority necessary to override a presidential veto.

The Trump Administration's deep antipathy for Iran means that the President is likely to continue to support MBS' foreign policies broadly, and U.S. mistrust for Iran, especially in light of Iranian threats to restart nuclear enrichment activities, means that Riyadh already has the upper-hand in the court of U.S. public opinion.

Despite a recent court ruling that threatens to disrupt British arms sales to Saudi Arabia, the UK is also likely to remain a key member of the Saudi-led coalition in the Yemen war, and to continue to cultivate positive relations with MBS regardless of who becomes the next British Prime Minister. In many ways, the UK is more deeply enmeshed with Saudi Arabia than the U.S. In addition to the historical legacy of the al-Yamamah arms agreement, there are broad reports of British Special Forces operating on the ground in Yemen side by side with Saudi forces. With the UK economy uncertain in the face of Brexit, the income from continued British fighter jet sales to Saudi Arabia has strong appeal. In addition, Saudi Arabia's investments in British stocks, bonds, and luxury real estate may finance as much as one-fifth of Britain's current account deficit, a fact that Riyadh reminded London of when seeking to secure British support at the outset of the war in Yemen in 2015.

Calls by the UN for further investigation into MBS' role in the Khashoggi murder are unlikely to yield meaningful results. The Saudis have their own suspects under trial, and will eventually hold them accountable. Further, without any ability to do more than recommend sanctions to a body that will never enact them, especially given Riyadh's courtship of Russia, the UN has no teeth. Further, the existential threat MBS has painted Iran to be to all Sunnis means that he will not only have absolute power to deal with internal security threats, but that he is also likely to enjoy a high degree of internal support from a population terrorised by Huthi attacks on their airports and oil infrastructure, and Iranian attacks on their tankers.

ECONOMIC STABILITY

The World Bank predicts growth in Saudi Arabia at approximately 1.7 per cent in 2019, as a result of government spending designed to offset the impact of the oil production cuts, but should recover to over 3 per cent in 2020. Inflation from the implementation of the Value Added Tax (VAT) in 2018 has been controlled, and the VAT yielded over \$12 billion in its first year, significantly surpassing estimates. However, achieving a balanced budget by 2023, as laid out in the Fiscal Balance Program that is part of Vision 2030 will require a significant rise in oil receipts, according to the World Bank.

MBS continues to push for achievement of his Vision 2030 program. However, Riyadh revised its goal for the National Transformation Plan 2020 in November 2018, posting a less ambitious agenda online. Goals that have been revised downward include female participation in the workforce, improved access to healthcare, and training for government employees. However, the revisions also included improving Saudi Arabia's ranking on Transparency International's Corruption Perceptions Index, currently at 58th out of 180 countries, scoring below 50 per cent on the perceived level of public sector corruption in 2018.

While the ARAMCO IPO has been slow to materialize, the company made waves with its bond prospectus, issued in April 2019. The prospectus revealed ARAMCO is the most profitable company in the world, netting \$111 billion last year. Moody's rated Saudi Arabia A1 "because of the close interlinkages between the sovereign and the company." Fitch similarly capped its rating at A+ due to the influence the state had on the company, despite the company's "high production, vast reserves, low production costs and very conservative financial profile."

These results prove Saudi unease about disclosing ARAMCO's corporate make-up and ownership structure was warranted. One result of this experience is that Energy Minister Khalid

al-Falih may step down from his position as Chairman of ARAMCO in an effort to put distance between the Ministry and the company, according to press reports from late June.

Assuming oil prices remain between \$80-\$85 per barrel, which the International Monetary Fund (IMF) estimates as Saudi Arabia's breakeven price. Another result of the bond prospectus is that there is debate about the actual breakeven price for Saudi Arabian oil. Forbes estimates ARAMCO's breakeven price at closer to \$40 per barrel in 2019, or about half of the IMF's estimates, raising questions about how a transparent split of ARAMCO profits from government expenditures may impact government spending. However, if ARAMCO's eventual stock market listing generates the \$100 billion Saudi officials hope to move into Saudi Arabia's Public Investment Fund as a result of the sale, then Riyadh should still be able to afford the high expenditures required by its Yemen campaign.

SECURITY

Saudi Arabia enjoys a relatively favourable security environment thanks to experienced security forces and strong counter-terrorism capabilities. However, Huthi attacks on Saudi airports and oil infrastructure have revealed flaws in Saudi Arabia's Patriot missile defence system, though whether the flaws are inherent to the system or the user is unclear. Either way, Huthi reach into Saudi Arabia has proven both more widespread geographically and destructive than it was at the beginning of the Saudi-led war against Yemen four years ago, facts which are reflected in Saudi Arabia's slight slide on the Global Peace Index to a ranking of 129 (out of 163). Increased Huthi capabilities are almost certainly due to Iranian support, which, in turn, is a direct result of Saudi intervention in Yemen. Huthi missiles have targeted airports in Abha and Jeddah in 2019, but have reached as far as Riyadh in 2017. The Huthi have thus far concentrated their attacks inside Saudi Arabia to air and oil infrastructure; however, should the U.S. and the UK continue to increase pressure against Iran, they should be prepared for the possibility of reprisal attacks against diplomatic facilities inside Saudi Arabia, not unlike the attack against the U.S. Embassy in Baghdad in May 2019.

As we have previously concluded, based on battlefield success in Syria, Iraq, and Yemen, Iran currently has the upper hand militarily, despite the fact that Riyadh spent billions more than Tehran on its military apparatus. Iranian military equipment is older than Saudi Arabia's, but Iran has more of it. It also has a significantly larger standing army with demonstrated field experience and professionalism, making Iran's order of battle, in direct comparison, more lethal than Saudi Arabia's. However, much depends on the extent to which the U.S. decides to militarily underwrite Saudi policy.

MID-TERM OUTLOOK

MBS will continue to escalate the conflict with Iran, no doubt with the expectation of U.S. political and possibly military support. We can expect to see increasing public information and propaganda wars, hacking, sabotage, and general preparation of the cyber battlespace to be a key domain of the conflict even if conventional military operations remain at the proxy level only.

Given that supply is more than meeting demand, OPEC+ will continue to curb outputs, keeping oil under \$80 per barrel. Combined with high military expenditures related to the war in Yemen, this could make Riyadh's goal of balancing the budget by 2023 more difficult. However, ARAMCO's bond sale was sufficiently successful that the IPO is likely to occur, probably in the next year, and is likely to generate a significant windfall for Saudi Arabia's Public Investment Fund. In addition, while oil prices remained relatively constant in the immediate aftermath of the tanker attacks in the Gulf of Oman, direct conflict between the U.S. and Iran, or continuing attacks on oil infrastructure and transportation in the Gulf, is likely to drive up the price of oil.

The recent allegations and exchanges between Iran and the United States, provoked or at least stoked by Saudi Arabia, ratcheted quickly to actions just shy of armed conflict. Press reports suggest that MBS was disappointed with Trump's decision to de-escalate. Since MBS only stands to benefit from U.S. military action against Iran, both domestically and internationally, we should expect continued efforts by both Riyadh and Abu Dhabi to convince the U.S. and the UK of nefarious Iranian activity that poses a direct threat to western interests, including, foremost, access to hydrocarbons.

However, while the Iranian gambit has worked well for the short-term, solidifying diverse support behind Riyadh and against Tehran, it may reveal well-warranted insecurity about Riyadh's ability to maintain its core international partnerships in the medium to long-term without significantly revising its strategy in Yemen. Certainly it has already impacted the close relationship between the UAE and Saudi Arabia. If the humanitarian costs of the Yemen war continue near current levels, international public outcry will likely force a change of policies in the U.S. and UK over the long-term, and possibly as soon as the next U.S. presidential election in 2020.