

Domestic and Foreign Challenges faced by Saudi Arabia

Alejandro V. Lorca

Since 9/11 Saudi Arabia has frequently appeared in the news – in particular due to its differences with the United States – and in the specialised energy press, because of the problems faced by its oil production and competition within the crude market. We could nevertheless state that what the country is really facing are internal challenges directly related to the need to establish reforms in its political structure, along with the resurgence of an ancient opposition that is gaining ground with the appearance of active and violent Islamism. Without a doubt it also faces important changes in the production and penetration of crude in world markets; however, in our opinion these latter problems do not pose such an important challenge as those facing the Saudi government in the domestic policy arena.

Saudi Arabia is considered a reference point within the crude sector, and in the Arab world it is the only country that has remained independent and not experienced colonisation. As we know it today, with its borders and political characteristics, its history began in the 1920s, when the Al-Saud family expelled the Hashemites from Hadfez and imposed Wahhabi Islam on the region. The country does not seem to have problems of religious legitimacy: its constitution is based on the Koran, and its law on Sharia law, meaning that a lack of democratic principles has not greatly affected domestic legitimacy. However, since 9/11 there is foreign insistence on the need for the country to initiate a transition towards democracy. And the United States in particular is pressuring for a change, although before the terrorist attacks this was not amongst its priorities.

Traditionally the Saudi regime has enjoyed a broad political base, the foundations of which lay on its commitment to different social classes: the Royal Family, the bureaucrats (in the military and in the administration), the religious class, businessmen, the remaining citizens, and foreigners. The Saudi regime has also been able to decentralise power amongst the

Alejandro V. Lorca, Jean Monnet Chair, Universidad Autónoma de Madrid.

regions and tribes, showing its ability to adapt to changes. It is of course true that oil revenues have made this possible. Saudi Arabia implements a liberal economic policy that has maintained the loyalty of businessmen. Oil revenues also made it possible for dissidents to be co-opted before they became the opposition. Additionally, the country has implemented infrastructure and social welfare policies that have been generous with regards to education and health; and a food supply policy aimed at sufficiency which, although costly, has allowed it to feed the population and win over its confidence.

The world's policy of moderation in the price of crude depends on Saudi Arabia. Its relations with the United States and expenditure on arms has allowed it to guarantee the loyalty of bureaucrats and military personnel in favour of perpetuating this relationship, amongst other reasons because many of them have been educated in America. The Royal Family and the Ulemas are loyal to the King, who is generous in his financial assistance. In this arrangement and political pact, money has substituted reforms. But these have become increasingly necessary in the face of strong demographic growth, underlying a generational confrontation between the predominantly youthful population and the older generation of the Royal Family and the Ulemas, who control political power and its execution. With regards to the technocrats and businessmen, they have considerable economic power that is based on their enormous resources, but in general the younger generation has neither resources nor political influence. And it is precisely within this sector of the population that the Islamic movement has taken a hold. As is often the case, a violent faction emerged, in this case led by Bin Laden.

Strong population growth has meant that a reform to the distribution of power has become ever more necessary. The danger is that increasing oil revenues might delay these reforms, fostering dependence on the earlier policy of substituting reforms with financial support. Faced with this booming younger generation in search of employment, the Saudi government seems to have chosen to pursue economic development, allowing it to create employment and slow down change. That is, it will give priority to economic growth over political transition. This economic growth can be seen throughout all the countries within the Gulf, and will very likely be enhanced by relations with emerging economies such as India and China. There appears to be some economic complementarity between the Gulf and the emerging Asian economies, helping Saudi Arabia's development policy attain its objectives and capture the loyalty of a new generation. Nevertheless, there is also a danger that the revenues obtained via sharp increases in the price of crude could centralise power in the older generation, reducing their will to compromise and undertake reforms. This is the true domestic challenge facing Saudi Arabia, at a time in which the business sector and the younger generation have intensified

their disapproval of the privileges enjoyed by the Royal Family. This is the main criticism stemming from the Islamic opposition, besides the relations that the government and the older generation of the Royal Family maintain with the US. For, over the long term, relations between the two states have not encouraged Saudi reforms, given that the US, with a short-term vision, has considered Saudi Arabia to be an inexhaustible source of energy and an unlimited arms market.

The United States does not import large amounts of crude from Saudi Arabia – the Asian market, especially Japan, is the main importer of Saudi crude. Nevertheless, since the 1940s, when President Roosevelt and the Saudi Monarch signed their famous pact, the two countries have maintained a very special relationship: the former became the protector of Saudi Arabia, providing it with technical assistance for the development of the energy sector, as well as its most important source of arms. And this was done without subordinating the Saudi state to US interests. However, when the nationality of the participants of the 9/11 terrorist attacks became known, the need for Saudi reforms was perceived by Washington as urgent, leading the two countries to drift apart somewhat, although more in appearance than in essence.

One of the benefits resulting from the relationship between the US and Saudi Arabia consisted in the application of a Saudi policy to crude production which generated a certain stability in market prices. Saudi Arabia was a source country that fulfilled the task of regulator: when circumstances caused a decrease in the production of crude exporting countries, the Saudis covered this shortfall, restraining the price rise resulting from the panic effect. This has been customary practice. The regulatory role was made possible by the fact that the country possessed idle production capacity at all times, as well as the capabilities to transport the oil. And Saudi finances did not need the revenue from this idle capacity.

However, circumstances have changed due to the strong increase in the demand for crude, mainly due to Asian economic growth. To this it is necessary to add rumours pointing to the existence of problems within Saudi oilfields, preventing the country from reaching its crude production objectives. At a time when the real production of crude is reaching maximum capacity, its regulatory role has become impossible. The OPEC will become ineffective, something that has begun to occur, because as real production nears maximum capacity, it is no longer possible to manipulate supply – which has been common practice until now. Hope has been placed on technological innovation and investment in countries with large reserves, like

*Hope has been
placed on
technological
innovation and
investment in
Saudi Arabia*

Saudi Arabia. Nevertheless, it is worth asking why a country would increase its potential capacity to extract oil, since this would work against its own interests and in the long term reduce the price of crude. All indications are that the new investments in the exploration and development of oil fields will take place in Iraq, given that the government in this latter country is taking steps to prepare a tender process for oil exploration.

Despite these developments, Saudi Arabia continues to possess 23 per cent of the world's verified commercial reserves, placing it in an important future position within the market – a world market that in turn is organised into regional markets: American, European and Asian.

In the American market, demand for crude is mainly represented by the US, with 20 per cent of the world's consumption. This market is covered by American producers, followed by countries from Western Africa, specifically from the Gulf of Guinea. The main supplier of the US is Canada. In Latin America it is followed by Mexico and Venezuela. Countries like Nigeria and Angola also supply the US market. Nevertheless, the production capacity of the American oil region and the Gulf of Guinea is not sufficient to cover the totality of American demand, thus the US must resort to Saudi Arabia to cover around 20 per cent of its crude imports. In the future US production of crude – the US is the world's fourth produce – will continue to decrease, and if the necessary legislation is not enacted – as the European Union has done – demand will grow, thus the need for imports will increase. Where will resources come from? It seems reasonable to expect that the American oil region will increase its production with the oil sands that are found in Canada, Venezuela, and even within US territory. However, it is not unlikely that they will need to resort to Saudi crude.

The second regional market is the European market. This market is divided into two sub-markets. On the one hand, the market on the European Atlantic façade, supplied mainly by Russia and the oil region of Liberia (with Russia transporting this crude through its pipeline system), and the countries of the Gulf of Guinea. On the other hand, the market of the European Mediterranean façade, supplied by North Africa, as well as the Gulf of Guinea. This same pattern, though more accentuated, can be found in the natural gas market, which is why Brussels is worried about its dependence on Russian oil and gas. It is true that in relation to the energy sector, Russia's behaviour with some of its clients, such as Ukraine, Belarus and Georgia, has not been very reassuring; however, Brussels' response has been excessive. In relation to the energy issue, both Russia and the European Union will have to engage in dialogue, given that concerns on the European side regarding security in the supply of energy are matched by concerns on the part of Russia regarding the continued existence of demand.

Nevertheless, the suppliers to the European market do not have the production capacity to cover total demand. The situation is similar to that

within the American market, and again it will be necessary to resort to Saudi Arabia to cover this deficit. Russian reserves are relatively small, and there are no guarantees that Russia has the financial capacity necessary to increase these reserves in time to cover the needs of the European market, nor that it is willing to do so. Foreseeably, Europe will need to resort to the Gulf and to Saudi Arabia.

The third market is the Asian market, whose imports are mostly covered by the Gulf, and in a much smaller proportion by Eastern Africa. It is believed that in the future Russia and the Caspian Sea will be able to supply the Asian market, but without a doubt the Gulf will be the main supplier.

These scenarios demonstrate that Saudi Arabia is one of the key players in covering the imports of the three regional markets for crude, and will continue to play this role. Perhaps it has lost part of its prominent role, but this is due to changes in the behaviour of the market.

We could say that the market is resolving the oil problem in the short term through an increase in price – the economists' solution. In the long term, the solution to the exhaustion of these resources – predicted by geologists – must lie either in the search for crude that is more expensive to extract (economists' solution), or in the introduction of new sources of primary energy through technological innovation. The problem lies in whether or not the discovery of these new oilfields and new technologies will coincide in time with the exhaustion of old oilfields. This is a question addressed by the economic theory of energy cycles, which nonetheless is unable to guarantee a transition without a crisis.

Thus, we believe that the main challenge facing Saudi Arabia is its ability to carry out domestic reforms in a timely and calm manner. In relation to the crude markets, it will continue to be the country with the most verified commercial oil reserves, placing itself in a privileged position within the market.

But it is necessary to highlight another change that is occurring discretely, as is common in Saudi Arabia. We refer to its foreign policy. Saudi Arabia has competed with Egypt for leadership within the Arab World and the Muslim World. Its instruments have been the legitimacy with which it is endowed because it is the custodian of the Muslim Holy Sights, Mecca and Medina, and its financial surpluses, skilfully used in foreign policy. Generally, the Saudi King – no matter which particular one – has not wanted any significant visibility in the Arab or international media. Nevertheless,

*Saudi Arabia
posses 23 per
cent of the world's
verified
commercial
reserves*

and since the Iraqi invasion, the Saudi House has chosen to directly participate in regional politics. There are various reasons that have perhaps forced the King to make this decision, despite the fact that it is a role in which he does not seem comfortable. The Iraq war has revived the old Shiite-Sunni conflict. In view of the fact that the Saudi Kingdom is Sunni, but with an important Shiite minority settled within the country's oil region, mediation in this conflict is considered a measure of internal politics. The Shiite minority complains that despite the location of the most important oil fields within their territory, their income is below the national average. The King has directly intervened in the Lebanese conflict and in the Palestinian conflict between Sunnis and Shiites, compromising his personal prestige. This policy, in view of the possibility that the conflict between these two Muslim groups could be extended beyond the Shiite parallelepiped (Iran, south of Iraq, north of Saudi Arabia, south of Lebanon, Gaza), together with Iranian nuclear policy – which is Shiite –, has driven the Saudi House towards a more direct initiative in regional politics. This situation could offer the country the possibility of attaining prominence within regional politics, which was not sought after in the past, and of greater political influence. Therefore, it does not seem as if Saudi Arabia is losing importance within the oil energy sector, nor in regional politics within the Middle East.