

**BRATISLAVA INTERNATIONAL SCHOOL OF LIBERAL ARTS**

**When the Ice Melts: Comprehensive Principle of decision  
making in Saudi Arabia**

**BACHELOR THESIS**

**Bratislava 2016**

**Samuel Hyravý**

**BRATISLAVA INTERNATIONAL SCHOOL OF LIBERAL ARTS**

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making in Saudi Arabia**

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## **Declaration of Originality**

I declare that this bachelor thesis is my own work and has not been published in part or in whole elsewhere. All used academic and other sources of literature are referenced and listed in Bibliography.

Bratislava, February 15, 2017

.....  
Samuel Hyravý

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## Abstrakt

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Účelom tejto štúdie je zistiť, kedy sú krajiny, ktoré sa zdajú byť prevažne ovplyvnené ich ideológiou ochotné prekonať svoje postoje a spolupracovať so svojimi nepriateľmi. Prípadová štúdia tohto javu je Saudská Arábia a jej ochota spolupracovať s jej ideologickým nepriateľom, Iránom. Táto práca argumentuje, že existenčná hrozba a potenciálne zvýšenie sili vedie k spolupráci aj medzi nepriateľmi. Saudská Arábia je ohrozená kolísaním cien ropy, dominanciou jedného sektora a zvýšením štátnych výdavkov. Zvýšenie sily Iránu ohrozuje mocenské postavenie Saudskej Arábie v regióne, zatiaľ čo nízke ceny ropy ju ohrozuje aj vnútorne. Saudská Arábia predstavil plán ekonomickej reformy, ktorá môžu výrazne zvýšiť jej silu, No veľké vládne investície sú nevyhnutné. Za účelom zvýšenia príjmov na reformu je Saudská Arábia ochotná spolupracovať s Iránom a zvýšiť tak potenciálnu silu svojho nepriateľa v krátkom horizonte. Avšak spoluprácou krajina zvýši svoju silu v dlhodobom horizonte. Táto práca dochádza k záveru, že hypotéza bola preukázaná a krajiny sú ochotné spolupracovať keď je ich sila a prežitie ohrozené.

## **Abstract**

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The purpose of this study is to examine when are countries that seem to be predominantly affected by their ideology willing to overcome their narrative and negotiate with its enemies. The case study of this phenomenon is Saudi Arabia and its willingness to cooperate with its ideological enemy, Iran. This thesis argues that existential threat and potential increase of power leads to cooperation even among the enemies. Saudi Arabia is threatened by volatile oil prices, domination of one sector and increasing state expenditures. Iran's increase of power threatens power position of Saudi Arabia in the region while low oil prices are threatening it also internally. Saudi Arabia introduced economic reform that can significantly increase its powers, however, large governmental investments are required. In order to increase their income Saudi Arabia is willing to cooperate with Iran and increase their power in the short run. However with the cooperation Kingdom will increase their own power in the long run. This paper concludes that hypothesis was proven and countries are willing cooperate when their power position is being threatened.

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## **Introduction:**

*“I remember when King Abdullah asked me to pass on to President George W. Bush in 2006 that he needed to cut the serpent s head and attack Iran.”*

Zalmay Khalilzad former US ambassador (2016)

What drives countries to overcome their disputes and cooperate with their enemies? Is even such cooperation among enemies possible? If so, can it be predicted? To explain this phenomenon, this paper will examine case study from the Middle East. The Middle East is region marked with brutal wars, numerous foreign interventions. Place where three major religions emerged and clashed. Out of blood and sand, great nations emerged. These great nations compete for dominance over the region. Ideology is everywhere, and some of the countries have the role of the religion even written in their constitutions. A case study of this research is examining Saudi Arabia and its position towards Iran. Saudi Arabia and Iran are currently two geopolitical enemies in the region. They keep using hostile rhetoric against each other “serpents head,” members of “Axis of Evil,” “sponsors of terrorism,” “mad mullahs”, ... Both sides used these and many other offensive labels. Iran and Saudi Arabia are sworn enemies fighting their ideological proxy wars in Yemen, Syria, and Iraq. However, we have seen signs of cooperation previously among these two enemies. Under what conditions are these two players willing to cooperate? Irrationality is one of the traits that is often used to describe both of these countries, mainly from the western observers. The main scope of this research is to provide the explanation of the seemingly irrational behavior of the state.

The main theoretical framework used in this thesis is realism. Notably Hans Morgenthau and his work *Politics Among Nations: The Struggle for Power and Peace* (1948) and in following additions his six principles of the realism. Realism in international relations stresses out the omnipresent possibility of war. Nature of the states, their selfishness, competitiveness alongside with the lack of higher institution

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results in this aggressive environment. For realists, international arena is anarchy where each state is pursuing its own interests. For Morgenthau, each state is pursuing interests in terms of power. States are not primarily concerned with morality, religion, ideology or identity. They are mainly driven by their own national interests of pursuing power and survival. Realists view nations as selfish competing players in the game without a referee. States are engaging in wars to eliminate their rivals. Just like they are forming alliances to fight their common enemies. States, for realists, are always anticipating conflict.

Hans Morgenthau in his six principles argues that politics is also governed by laws rooted in the human nature. Despite the fact that realism is preoccupied with interest defined in terms of power he claims that realists also acknowledges different associations with power in regards to changes in time and circumstances. Morgenthau also points out to the realist's awareness of moral significance for the state and decision itself. However, successful political actions remain the central priority. In his fifth article, he articulates the fact that realists refuse to identify moral values of one nation as universal therefore superior values governing the universe. Ironically, fight in the name of morality, and higher values are often used as a framework of mobilisation for the conflict (Morgenthau, 1978).

He argues that decision making of the countries is driven by interest defined in terms of power. Morgenthau emphasizes on the rationality in the international relations. He argues that rational foreign policy is essentially a good foreign policy. This is because the outcome of the foreign policy is the rational calculation of the costs and gains of each decision. This rationality focuses on minimising costs and maximising benefits. Therefore for realists, prudence, ability to successfully make a decision is the most important trait of the leader. They also argue that states are not primarily concerned with the ethical, ideological, religious interests rather using them as political tool how to maximise their power. Just like states are focusing on increasing power and their survival so are leaders of the countries pursuing the same goal inside the country. In this case, the al-Saud clan is focusing on their survival and

maintaining power inside the country. This paper argues that it is rationality of the careful calculations that led to the shift of the approaches that might seem for some of the observers as irrational.

Realist approaches argue against the Hinnebusch's (2003) analysis of the region where he argues that it is also pan-Arabism and identity of the belonging to the Arab nationality that drives countries to fight or cooperate. However, since the Gulf war, it is evident that this cleavage among Arabs and Persians isn't that significant. The same logic can be applied to the sectarian question. One might argue that it is the ideology of the particular branch of Islam, that drives countries in their decision making. This explanation is based on the real grounds, Islam, without any doubt, is significant for Saudi Arabia and Iran. However how decisive is this factor? This paper argues on it is used only for the political reasons as a tool how to increase the power. Barnett (1998) in his book describes the birth of Iran and Saudi Arabia. He argues that Islam played a significant role in the development of both of countries and the Middle East region as such. Early origins of their sectarian conflict emerged in the 7th century when the polarisation of the whole region into Sunni and Shia Islam began. It was under Safaris, militant Shiite group, when Shiism became state religion in Iran. But the majority of Iranian were still Sunni, this all changed with the rule of Ismail around the year 1500 when he began the brutal campaign to convert Sunni's to Shiism. Barnett identifies three significances of Islam for the leaders in the region and those are moral order, social organisation, and political mobilisation. Wehrey (2009) argues that clearer cleavage among the countries of the Middle East happened after the fall of Saddam Hussein in Iraq. Both Iran and Saudi Arabia represent two major sectarian groups. Shia and Sunni support different sides in the whole region. Proxy wars between the two groups in Syria and Yemen resulted in an antagonistic relationship between two states, at least on the rhetorical level. Wehrey (2009) claims that Saudi's support of Wahhabism (see chapter 1.3) was primarily used as a tool how to gain dominance in the region. But ideological conflicts can be overcome, as Wehrey (2009), and Fürtig (2002) argues. Wehrey gives us an example of Lebanon where both sides cooperated to alleviate the situation in the country. Or during Saddam's invasion

of Kuwait where both sides agreed that they need to oppose such violation of regional balance (Fürtig, 2002). Beydoun & Zahawi, 2016 argues that Islam became the primary strategy how to increase regional power for Iran and Sunni Gulf states. They also classify this as the main reason why the whole region became polarised. This fits with the realist approach that perceives the struggle for power and survival as the primary goal of states. The Recent significant shift in the balance of powers happened when nuclear the deal between Iran and United Nations Security Council's five permanent members (P5+1) was signed. Beydoun and Zahawi considers this deal as significant in normalisation of the relations with the Gulf States and Iran. They highlight the fact that commerce and economic benefits are the main driving force of this normalisation. Hussein and Abdullah (2015) in their work analyse outcomes of the Iranian isolation that lasted for years and consequences of nuclear deal on Iran. For them, the whole deal strengthened the position of Iran in the region and their power to negotiate with others. Despite the opposition to the deal from the entire Gulf block, but mainly Saudi Arabia, Hussein, and Abdullah (2015) expect increasing cooperation between two of them. They agree with Beydoun and Zahawi that cooperation among Saudi Arabia and Iran is expected due to the possible economic gains for both of them. Iran, as a major economy re-entered the market and is aiming to boost its oil production. As Hinnebusch (2003) writes, foreign interventions were and still are so prevailing and important in the region that foreign powers and their influence have to be taken into account in every analysis of the decision-making in the Middle East. He also highlights the importance of the state formation and its effects on foreign policy.

**Thesis:**

When identity and ideology in Saudi Arabia seems intractable aspirations for power intervene. When money talks, interests are being decided, identity and ideology becomes secondary.

RQ: What force can move seemingly intransigent loyalties to identity and ideology?

Power position is threatened by:

- External economic pressure
- Economy dominated by one sector
- Changing power relations

Hypothesis: When a power position of a country is at stake, impacted by external economic pressures, vulnerable national economy due to domination of one sector, and changing power relations, the country will be willing to overcome even seemingly intransigent identity and ideological barriers.

The primary goal of this research is to explain what forces a state to overcome their seemingly intransigent ideological positions. By examining the case study of Saudi Arabia and their recent agreement with Iran that led to decrease of their oil output, this work aims to prove that even extremely hostile nations can reach a deal. When their survival is being threatened, and the possibility of increasing their power occurs even the most sectarian countries are willing to cooperate. To explain the significance of this deal, antagonistic relation between these two nations will be examined. Followed by analysis of the deal, description of the Saudi Arabian economy how important is oil for their economy. Changes in the oil prices and implications of these changes on power position of Saudi Arabia. Alongside with sudden change in the situation for Saudi Arabia that significantly contributed to this willingness to cooperate. Further research on previous cooperation is necessary to prove how can existential threat push these countries to change their positions.

# **Chapter 1: Islamic schism**

## **1.1 Brief history of the Middle East**

To explain nature of the relation between Saudi Arabia and the question of the sectarianism birth of both countries needs to be examined.

### **1.1.1 Formation of Saudi Arabia**

Years of constant fighting among the tribes, Emirates, and clans in the Arabian Peninsula preceded unification of the Saudi Arabia. Eventually, it was Al-Saud clan in 1932 that emerged as victorious and conquered majority of the Arabian Peninsula. The kingdom of Saudi Arabia was established with the ruling al-Saud family.

Abdul Aziz Ibn Al Said became the first king of the newly formed monarchy. The Royal family are members of the Sunni branch of the Islam, like the majority of the Saudi Arabia. Approximately 10-15% of the population are Shia (CIA Fact Book, 2017). Due to the contribution of the Sunni scholar Wahhabi that helped al-Saud clan conquer Arabian Peninsula Wahhabi Islam (see chapter 1.3.1) became dominant. It played an enormous role in the early days of the Saudi Arabia. Wahhabi scholars controlled education, policies related to the religion and even religious police was created to oversight the compliance with the Islamic law (Matthiesen, 2013, p.22).

### **1.1.2 Iranian Revolution**

Formation of Iran is only summarised from the Iranian revolution that shaped it to Iran as we know it today. However, the role of the clerics can be traced much further.

Rising unemployment, the collapse of the oil prices, continued political instability, in 1950ties Iran had twelve prime ministers in a period of twelve years (Kamrava, 2005, p.142). Alongside with significant powers of the tribal societies over some parts of the Iran and years of strong absolutism, all added to the weakness of the Iran and discontent of the population with the government. Another major factor that contributed to the revolution were fast reforms (Walt, 1996, p. 211). In 1962 ruler of Iran Shah, Reza Pahlavi introduced his vision for the reform that became known as the White Revolution. However, support for the opposition of the change was much greater than for the Shah's reform. Opposition to the monarchy was led by the conservative clergy that perceived Shah's reform as a threat to their powers. The leader of the opposition was Grand Ayatollah Rouhallah Khomeini (Kamrava, 2005, p.146). Ayatollah represents highest religious figures in the Shiite branch of Islam. Monarchy was successfully overthrown, and the Islamic Republic of Iran was established on February 11, 1979. Ayatollah Khomeini became first Supreme Leader of Iran. The position that to this day possess major powers over the Iranian decision making (Walt, 1996, p. 214). Following the revolution, Ayatollah called for Islamic revolutions in other Islamic countries, to disrupt current system of the monarchies in the region (Walt, 1996, p. 214). Iran supported coups and unrests across the Middle East (Molavi, 2015, Walt, 1996, p. 244).

In 1981 Ali Khamenei was elected as president of Iran. After the death of Ayatollah Khomeini in the 1989 Ali Khamenei became next Supreme Leader of Iran. He shared some of the Ayatollah's visions However his reign was perceived as a movement towards normalisation (Walt, 1996, p. 221). The death of the Ayatollah Khomeini allowed for more technocratic and less ideologically driven government of Akbar Hashemi Rafsanjani who was elected as president in 1989. He introduced goals of improving relations with the Arab neighbours and Iran (Kamrava, 2005, p. 162). However, the biggest shift came in 1997 with the election victory of Mohammed Khatami. He continued with policies of the relations improvement of the previous president. He organised the conference on the cooperation where Saudi Crown Prince Abdullah visited Iran. It was the highest official state visit from Saudi Arabia since

1979 (Molavi 2005). Next major shift in the direction of Iran came in 2005 when Mahmoud Ahmadinejad was elected as new president. He revisited Iranian foreign policy and immediately after his election started to develop Iranian nuclear program and increased support for the Shiite groups across the region. The approach of normalisation came with a victory of the Hassan Rouhani, once again more cooperation and reformation oriented president. His election was welcomed both, by the United States and the Gulf Cooperation Council members. He managed to partially liberalise the economy of Iran even before the international sanction were lifted (Beydoun & Zahawi, 2016). He also and successfully reached an agreement over Iranian nuclear program (see chapter 5.3).

## **1.2 Conflict that disrupted the balance of power**

After the World War II, years of balance of power between Iran, Saudi Arabia, and Iraq dominated the Gulf geopolitics. However, as the power of Iraq started to decline Iran reacted and exploited it. Increasing propaganda and support for the Shiite groups at the Iraq-Iranian border led to increased tensions. Iraq perceived rising Iran as a significant threat, and as a result in 1980 Iraq invaded Iran. The Iraqi-Iranian war lasted until 1988. As a response to the rising power of Iran, its propaganda and support for the Shiite groups but also the direct conflict with another Arab country, six Arab countries, Bahrain, Kuwait, Oman, Qatar, UAE and Saudi Arabia created the Gulf Cooperation Council (GCC). Following the war, economic problems of Iraq led to the invasion of Kuwait by the Iraq to capture Kuwait oil fields. As a response to the invasion, United States formed coalition constituting of 34 countries to defend Kuwait. The War lasted from 1990 to 1991. And finally, in 2003 United States invaded Iraq to remove Saddam Hussein from power and changed the dynamics of the region. Destabilisation of Iraq led to increased influence of both Saudi Arabia and Iran that came out as winners out of these conflicts. Since then, the Middle East and North Africa region became shaped by the geopolitical conflicts among Saudi Arabia and Iran. These conflicts were framed in the sectarian light by the both actors, however not driven by it. Power interests remained primary driving force (Molavi, 2015). Use

of the religion in political tool to maximise the power of country was described by Morgenthau in his second principle of realism (1978).

### **1.3 Sunni - Shia cleavage and clashes in the region**

Since Iraq, the third major power in the region significantly weakened geopolitical competition between remaining two players started to increase. As mentioned before, both used religion as the political tool to gain influence over the area. The polarisation of the region in the light of the sectarianism significantly added to the current problems and rise of the extremism in the area. With the Saddam's Iraq and its mixed population of Sunni's and Shia, the sectarian question wasn't that vocal from the leaders. The line was previously driven between the Arabs and the Persians. However, with the fall of Iraq region started to polarise based on the religion. And religious cleavage began to increase.

#### **1.3.1 Sunni & Shia**

The Sunni-Shia conflict has lasted for 1,400 years. The conflict began Prophet Muhammad's death in 632 He died without appointing his successor to lead the Muslims. Sunnis believe that the first caliph, leader of the Muslims should have been Abu Bakr, the close friend, and advisor to Mohammed. While Shia's believe that this title is supposed to be inherited by the bloodline. Therefore, believing that the Prophet's son-in-law Ali was destined to become the first Caliph to lead the Muslims. Eventually, both held this title. First Abu Bakr and after deaths of two other caliphs Ali held the title. However, while Sunni depends heavily on Sunnah, the teachings of the Prophet Shia perceives their Ayatollahs as the reflection of the God on Earth. Conflict among Sunni's and Shias was also marked with the dogmatic teaching of the Wahhabism. This teaching was born in current Saudi Arabia, and it was also Saudi Arabia that helped it to spread across the world. Through numerous charities and organisations Saudi Arabia spread the Wahhabi ideology that is often connected to the terrorist cells. Wahhabi Islam can be traced to the eighteen century when religious

scholar Muhammed Ibn And al-Wahhab allied with Al Saudi family. The ultimate goal of this strain of Islam was to purify and eradicate all the deviations from “pure” form of Islam. Shia Muslims became a target of Wahhabi scholars and perceived as non-proper Muslims (Matthiesen, 2013, p 21).

### **1.3.2 Sectarianism as a tool**

Actions of the citizens from other Arab countries in their uprisings against the government that became known as the Arab Spring also affected citizens and the government of the Saudi Arabia. The mass protests in Tunisia, Egypt, Yemen and Bahrain spread fear among other Gulf states. Countries responded; differently, however sectarian rhetoric was used primarily in Saudi Arabia as a response to the protests (Matthiesen, p. 18). Fears that protests might spread from Bahrain to the Eastern Shia province of the Saudi Arabia and turn into united opposition of both Shia and Sunni-led to this sectarian language. To prevent this opposition, the government aimed to polarise the population (Matthiesen, p. 19). The question of sectarianism was also brought up in the context of the civil war in Syria. Conflict in Syria was being framed as the struggle between Sunni and Shia to eventually increase their powers (Metthiaesen, p. 19). Gulf states were also using sectarian threat narrative as a political tool how to delegitimises widespread protests. (Metthiesen, p. 20) According to the Metthiesen, the majority of their conflict are rooted in their geopolitical aims. However, both countries are using religion, the Sunni-Shia conflict as a political tool to mobilise and justify these conflicts. (Metthiesen, p. 20, Beydoun & Zahawi, 2016) When the Arab Spring protests began in Bahrain in February, it took only three days to protests spread to the Eastern province of Saudi Arabia. Fear of the further spread and escalation of the protests forced Saudi Arabia to send troops into Bahrain. However, in 2014 oil priced were higher and therefore King Abdullah also announced massive governmental spending on social benefits, housing, religious building, and infrastructure to buy the support for the protesters. These unrests led to 28% increase in the governmental spending that year (Matthiesen, 2013, p. 24).

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It is important to note that Saudi's fear from the protest in the Eastern Shia province are based on their experience from the past. Saudi's problems with the Eastern region can be traced to early years of the kingdom. From 1970 Saudi religious students started to spread revolutionary vision, these students studied in predominantly Shia countries Iraq and Iran (Matthiesen, 2013, p. 23). Ongoing problems with Shia minority led to repressive measures. The current constitution of Saudi Arabia requires all its citizens to be Muslims. However, in 2009 government strengthened its measures against Shia's and banned construction of any new Shia mosques. This minority was also stripped off the right to protest. This led to significant increase in illegal protests in the Eastern Province (Freedom in the world, 2016). Following the Iranian revolution and rhetoric of the Ayatollah Khomeini led to greater fear of the GCC countries regarding protests of their Shiite minority group (Walt, 1996, p. 243). As a response to the threat, many GCC countries increased economic support for the citizens to suppress any potential unrests in exchange for subsidies (Walt, 1996, p. 244). Following US invasions of Iraq and Afghanistan, support for the Shiite groups across the region under the presidency of the Mahmoud Ahmadinejad resulted into clashes through the proxies and rising tension among Saudi Arabia and Iran.

## **Chapter: 2. Sudden cooperation**

On the 30th of November 2016, Oil Petroleum Exporting Countries (OPEC) members met in Vienna, Austria for 171st meeting. Members agreed to adjust the oil production once again to increase crude oil prices. OPEC abandoned production quotas and price targets in November 2014 (Commodity Markets Outlook, 2017, p. 14). Two months of intense negotiations preceded the agreement. The agreement was based on recommendations of the High-Level Committee that was set up after the extraordinary 170 meeting in Algiers. As a result, producers agreed to cut 1.2 million of barrels per day (mb/d) from October 2017 oil outputs numbers targeting 31.9 mb/d. Saudi Arabia agreed to reduce its production by 0.49 mb/d while agreeing to allow the Islamic Republic of Iran to increase their production by 0.09 mb/d. To maintain production at the agreed levels, OPEC members also agreed to establish High-level Monitoring Committee responsible for monitoring production levels in each country (OPEC 171st meeting, 2016). Agreement came into effect on January 1st, 2017. OPEC members also met with non-OPEC oil producers to mutually agree on the cuts, these producers agreed to also reduce their production and establish High-level Monitoring Committee with the same purpose. This agreement reduced oil production since cuts from Oran in 2008. Iraq participated in the cuts for the first time since 1998. For the first time, non-OPEC countries are involved in the production adjustments. (Oil Price Volatility, 2016).

The Fact that Saudi Arabia was willing to cut its production, while Iran was allowed increase their own goes against the previous strategy of the monarchy. Reducing own potential economic gains and agreeing to increase Iran's would be hard to imagine several years earlier. Even a few months ago Saudi oil minister intervened and refused to agree to a similar proposal. So why would Saudi Arabia, so vocal about the "Iranian threat" suddenly agree upon cooperation with Iran? This paper argues that it is a result of the calculation of the potential risks and benefits. Global situation is radically changing, both politically and technologically. Power of the Saudi Arabia

is being threatened both internally and externally. While threats and state expenditures are increasing, income is decreasing. All of these factors contributed to the recent political shift. However it is power position of a country impacted by external economic pressures, vulnerable national economy due to the domination of one sector, and changing power relations, led to change of the position. In order to explain how are low oil prices threatening Saudi Arabia, what changed from previous years and description of the economy of Saudi Arabia is necessary.

## **Chapter: 3. Oil**

### **3.1 Summary of the economy of Saudi Arabia.**

Revenues from the oil are crucial, part of the Saudi state budget and therefore survival of the country depends on oil, at least for now. Revenues from export reached \$205.3 billion in 2016, petroleum and petroleum related products represents 90% of this income (CIA, 2017). Saudi Arabia is a country with second largest proven oil reserves. There are at least 260 billion barrels of proven reserves. This would last for the next 68 years with current production levels (CIA Fact Book, 2017). Most of these reserves were discovered in the Eastern, predominantly Shia province of the Saudi Arabia (Matthiesen, 2013, p.22). However, Saudi Arabia aims to increase its production and continue with searches for new reserves of the crude oil. This requires significant investment in the oil sector. Saudi oil ministry estimates that government will need to invest 70 billion US dollars to meet its goal of producing 20 to 30 m/bpd in 2025 (Al-Naimi, 2006). The price of oil fell by 80% since June (2014) till February 2016 (WOO, 2016, p. 1). Existential dependence on oil prices due to the lack of alternative income for the country in combination with the low oil prices resulted in the record state deficit. In 2015, Saudi Arabia hit record state deficit of \$98 billion (Freedom in the world, 2016). Another important feature of the Saudi Arabian economy is the royal family itself. In 2005, there were around 3200 royal members in the King Abd al-Aziz's immediate family. The annual average cost to sustain each of the members was \$1 million. However, when counting also King's brother, six of his half-brothers, all the cousins and families into which the Al-Saudi clan married number of the royal family members dramatically increases. Under this calculation, there is estimable around 30 000 members of the royal family. The cost of sustaining them could add up as much as \$10 billion a year (Raphaeli, 2003). Another problem of the economy is youth unemployment, and currently, it presents one of the biggest challenges for the country. As much as 45.41% of the population are under 24 years old (CIA Fact Book, 2017). Another major problem for the Saudi economy represents foreign workers. In 2008 there were approximately 8m of foreign workers out of

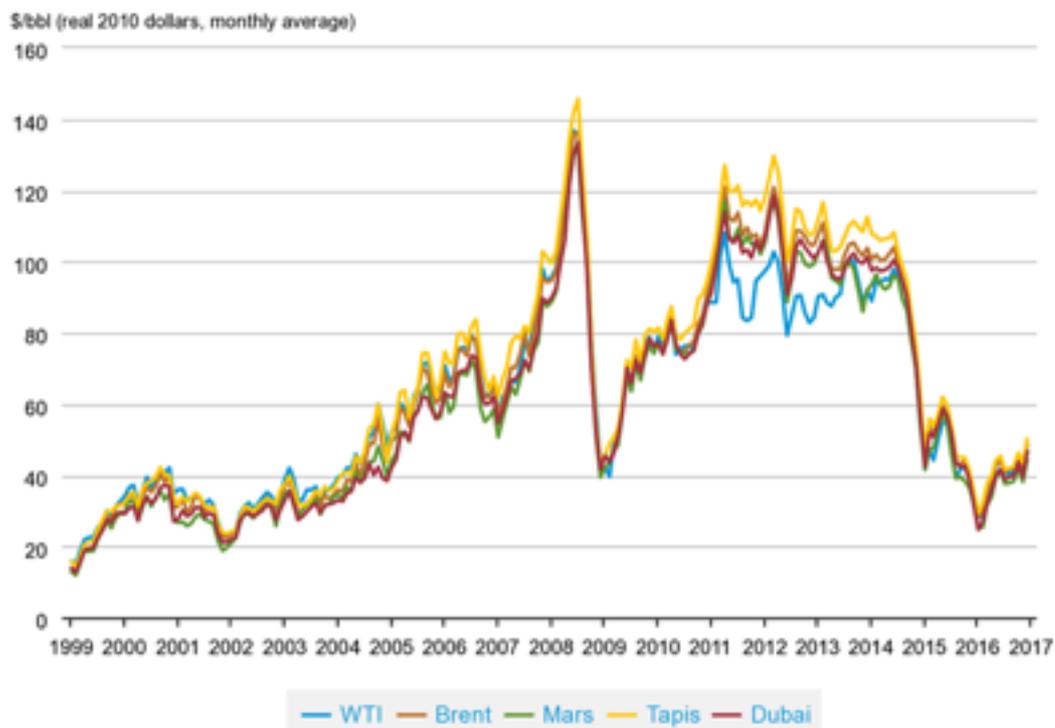
24.7m citizens of Saudi Arabia (Varia, 2015, p. 15). The Kafala, or the sponsorship system where foreign workers are required to have Saudi sponsor to enter the Kingdom. This results in low mobility across the occupation since employees are bonded with the employer. Sometimes creating almost slavery-like conditions for the workers (Varia, 2015, p.3). All of this results in the minor portion of the private sector contribution to the economy. The majority of the business are controlled by the royal family, and freedom house ranked Saudi Arabia on 94th position in the ranking of how easy it is to do business in the country. On the scale from 1 representing the best environment for the start of new business to 190, Saudi Arabia compared with its regional partners is ranked 8th out of 20 out of the Middle East and North Africa (MENA) region (Ranking of economies, 2016). The regime for decades subsidised its citizens in exchange for the obedience. All of these features of the Saudi Arabian economy also contributed to the fact that only 10% of the state budget comes out of the oil sector.

Existential dependence on the oil revenues and location of the majority of the oil wells in the East Shia province led to increasing budget spending on the security. However, it isn't the only importance of the oil, locations and volatile of the oil prices that threatens Saudi Arabia. Saudi Arabia is also using Strait of Hormuz as a means of transporting the oil the oil. 17 millions of oil barrels are shipped through Strait of Hormuz each day. It provides the only sea passage from Gulf of Oman to the Persian Gulf. 30% of oil world trade is shipped through it. It is the most important oil trading route in the world (EIA, 2014). It is the main trading route to the Asian markets. A Saudi Arabian, main export partners are China 13.2%, Japan 10.9%, United States 9.6%, India 9.8%, and South Korea 8.5% (CIA, 2017). In total, up to 68% of their export goes to the Asia. Strait of Hormuz is the potential weakness of Saudi Arabia, and potential blockade can further decrease oil revenues. Iran repeatedly threatened to “close the Strait.”

### 3.2 Changes in the oil prices

The role of demand and supply is one of the most important factors in affecting crude oil prices. The provision and demand of the oil are being impacted by both market and non-market conditions. Oil is also frequently used as speculation tool at the stock market adding to the volatility of oil prices (Mottaghi, 2016, p. 3). Countries also tend to use oil as the strategic tool also significantly affecting its price and adding to the volatility. Another element that adds up to this is the inelasticity of supply and demand in the short term. It takes the time to adjust production and in the case of consumption new technologies or sources are required to replace the oil as a source of energy.

#### World crude oil prices



 Source: Bloomberg L.P., Published by: U.S. Energy Information Administration

As mentioned before, oil prices fell by 80% (see chart above) from June 2014 and January 2016 (WOO, 2016, p.1). In June 2014 price for the barrel of oil was around \$100 and it fell to \$22.4 in January 2016. This means that daily decrease of the

## Hyravý: When the Ice Melts

income to the state budget based on production from the January and compared with the prices from January and June was \$814 800 000. Prices of the oil were even higher when peaked \$140 in June 2008. Economic think tanks, OPEC itself, World Bank and others analyse the current situation and forecast oil prices, demand and supply numbers to be expected in years to come. The problem is, that market can change rapidly. International events such as war, major terrorist attack are affecting it. The growth of the major economies such as Chinese, US, and German also significantly affects demand. But also environmental policies, technological advances in transportation and the industry are decreasing the demand. World Bank Global Economic Prospects report (2017) dropped forecasted gross domestic product (GDP) growth of the Saudi Arabia. In 2015 it reached 3.5% growth, in 2016 it was 1% growth, and it is expected to reach 1.6% in 2017. Compared with Iran where GDP rose in 2015 by 1.7% despite the sanction, and in 2016 it reached 4.6% as result of the sanction lift. In 2017 Iran is expected to grow as much as 5.2%. European energy consumption is decreasing for past six years, and it is very unlikely that anything will change (Eurostat, 2016). The European Union adopted Europe 2020 strategy (2016) that sets up the target of 20% energy coming from the renewable energy sources and 20% increase in energy efficiency. And 2030 Energy strategy that aims 27% of the energy to come from the renewables (2030 Energy strategy). However, OPEC in its World Oil Outlook 2016 (WOO, 2016) expects European Union to review its goal from previous 27% to 30% of the energy coming from the renewable (WOO, 2016 p. 48, 2030 Energy Strategy) In the WOO 2016 OPEC displays analysis of the current markets and forecasts demand, supply and possible changes in the economy. Most of the oil demand is expected to come from the emerging markets (WOO, 2016 p. ADD). OPEC acknowledged dramatic technological development achievements, energy efficiency, and environmental policies and adjusted their forecast for 2040. They decreased expected demand by 0.4 mb/d (WOO, 2016, p.2). Global macroeconomic conditions have continues to offer challenges that might pose problems for the stability of the prices. Questions about global economic growth, environmental policies and political uncertainties in both oil producing and consuming countries constitute a threat to the oil prices (Oil Price Volatility, 2016). In

the report, OPEC forecasted three different scenarios, most optimistic one is used for the reference. However, most pessimistic one is worth mentioning since it shows how uncertain these projections are. According to most pessimistic forecast will oil demand reach only 98.3 mb/d in 2040, that represents 11.1 mb/d decrease compared with the most optimistic scenario (WOO, 2016, p. 19). These changes depend on the uncertainties in the forecast. Technological developments and political effects on the economy are hard to predict. Therefore actual demand might be even lower. Another factor that might dramatically influence world oil demand is the US. OPEC expects US energy demand to rise. However, this might change with new president Donald Trump (see chapter 5.4.3). OPEC mentions two major uncertainties that might significantly affect actual demand, and that is the development of the Chinese economy and impact of the Brexit on the European and world economies (WOO, 2016, p. 28). OPEC in their forecast depends heavily on the Asian markets and developing countries. These countries are experiencing significant environmental issues, and further governmental interventions are expected. For example, Hong Kong provides subsidies for some of the electric cars. And according to the official press agency of the People's Republic of China, Car Qi acting mayor of Beijing promised to continue improving Beijing air quality also in 2017. Last year Beijing targeted coal use and high polluting vehicles. This year, Beijing's last coal power plant will be shut down, coal consumption will be cut by 30%, and about 300 000 high-polluting cars will be taken down (Xinhua, 2017).

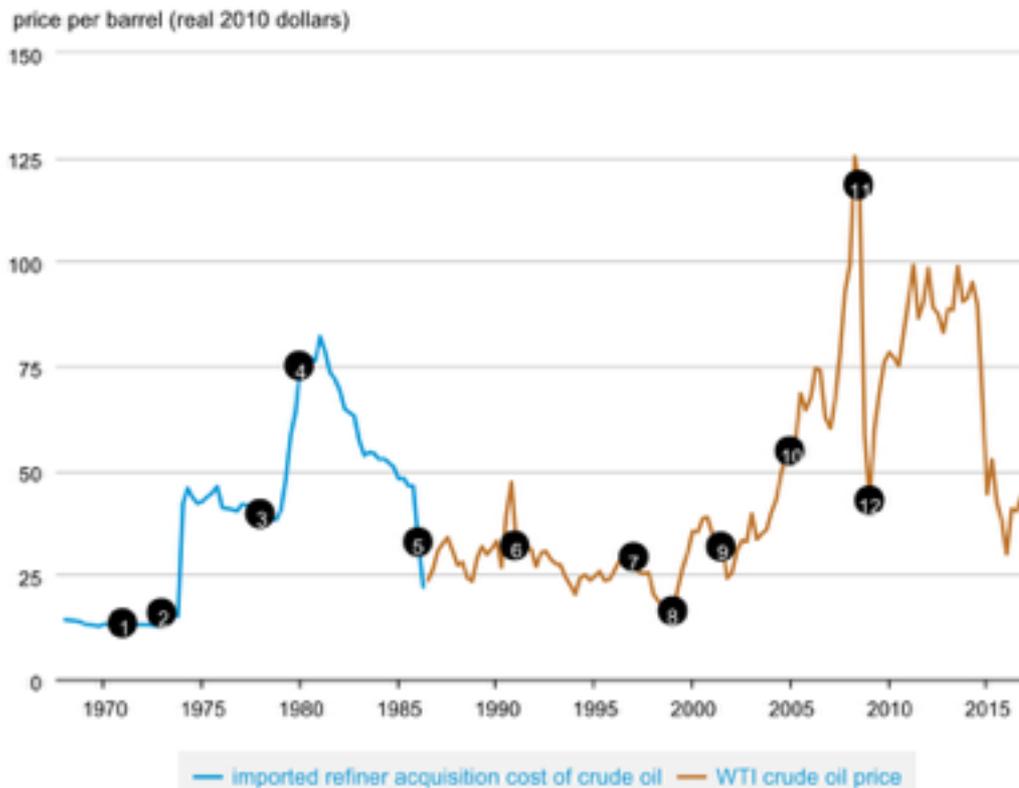
In the chart below we see how crude oil prices react to geopolitical and economic events represented by the numbers on the chart:

- 1: US spare capacity exhausted
- 2: Arab Oil Embargo
- 3: Iranian Revolution
- 4: Iran-Iraq War
- 5: Saudis abandon swing producer role
- 6: Iraq invades Kuwait
- 7: Asia financial crisis

## Hyravý: When the Ice Melts

- 8: OPEC cuts production targets 1.7 m/bpd
- 9: 9-11 terrorist attacks
- 10: Low spare capacity
- 11: Global financial collapse
- 12: OPEC cuts production targets 4.2 m/bpd

### Crude oil prices and key geopolitical and economic events



 Source: U.S. Energy Information Administration, Thomson Reuters

### 3.3 Implications of the changes in the oil prices

As mentioned before, Saudi Arabia heavily relies on revenues from oil. It is due to the changes in the oil prices it hit a record state deficit. International Monetary Fund estimates that oil prices of \$105.60 are needed to balance the budget, which is more than twice of the current levels (World Bank, How Saudi Arabia reacts to low oil prices, 2016). Decreasing reserves and shrinking state budget are threatening the position of Saudi Arabia. Revenues from oil are used for subsidies and military

operation in the region. Long lasting low oil prices are posing the existential threat to Saudi Arabia, both internally and externally.

### **3.3.1 Internal**

Royal al-Saud family maintained their power in the Kingdom through a “social contract” with the citizens. Residents gained economic benefits in exchange for their political rights. Decrease, or total elimination of these benefits could reduce support for the royal family and with increasing external pressure from Iran unsatisfied Shiite minority might revolt. Saudi Arabia witnessed Arab Springs in its neighborhood, some of the protests even spread to the Saudi Arabia (see chapter 1.3.2). This contributed to an increase in governmental spending on internal security undertaken to maintain the order. Members of the royal family are still on alert for a potential revolution (Matthiesen, p. 18). Like many other oil producing countries, Saudi Arabia subsidizes huge variety of products to maintain political stability. This policy began in 1970 when subsidies on food and electricity alone reached \$1.6 billion. New cuts that were introduced following the economic crisis in 1998 did not last long. In 2002 subsidies again skyrocketed and reached \$2.652 billion (Gürer & Ban, 2000). Mann (2010) concluded that it is most likely that the royal family will prefer to maintain the current conditions and not take the risk of changing the status quo. However, state deficit keeps increasing, and state budget income shrinking. A recent decision made in Saudi Arabia is the sign that status quo is slowly changing. Deputy Crown Prince Muhammad bin Salman al-Saud introduced his “Vision 2030” as part of the National Transformation Program (see Chapter 5). However, fast reforms might pose a risk. Iran witnessed revolution due to the financial problem, decreasing support for the government and sudden series of changes. Financial problems as results of the low oil prices pushed royal family to take extreme steps. For the first time, Value Added Tax (VAT) will be introduced to the Gulf Cooperation Council members. Following record state deficit government reduced subsidies for fuel, water, and electricity as a result price of these commodities has risen by 60%(Freedom in the world, 2016).

Eastern Province poses a threat to the Saudi Arabia; it is a strategic region for the economy however it is home to a suppressed religious minority. Citizens witness the power of the protests in neighboring countries; they realise how important are the oil fields for the regime and how they can be used as the source of funds for a potential rebellion. Possible conflict in this area could paralyse the entire country as it would significantly lower the Kingdom's income

The radicalisation of the political opposition alongside with Shia and Sunni fundamentalists led to increased Saudi spending on security following increased number of terrorist attacks and illegal protests in the Eastern Province (Mann, 2010). According to the data accumulated from 1970 to 2015 by National Consortium for the Study of Terrorism and Responses to Terrorism (START), Saudi Arabia witnessed a massive rise in the number of terrorist attacks on its soil. In 2015 103 cases of terrorist attacks were reported, compared with 14 cases in 2014 it is an enormous increase. Just for the record previous, all time high was in 2004 where 17 attacks happened (START, 2016). It was in this period when 18% increase in state expenditure occurred in years between 2001 and 2003 to due to the war in Iraq and increased terrorist activities in the country (Mann, 2010). Terrorist activities are growing in the whole region; they peaked in 2014 with 7000 reported terrorist attacks in the Middle East & North Africa region (START, 2016). Most recently in 2015 governmental spending increased by 13% as previously planned a result of additional salaries for civil and military employees (Khateeb, 2016). Riyadh's defence budget has been rising by 19% annually since Arab Spring uprisings in 2011. This clearly reflects fear of potential protests and regional unrests (Khateeb, 2016). These concerns are based on previous actions of Iran. Iran provided funding and support for uprisings and coups across the Middle East (Molavi, 2015, Walt, 1996, p. 244).v

### 3.3.2 External

In its geopolitical struggle in the region, Saudi Arabia and Iran are supporting different groups across the area. In Syria for example, Saudi Arabia is supporting rebels in opposition to the Syrian President Bashar al-Assad while Iran supports the government. Both countries realise that if their proxy wins, they will control the path of the country. Behind the mask of the sectarian struggle between Sunni and Shia, a complicated geopolitical game is being played. Saudi Arabia expanded its indirect support to direct military intervention in Yemen. Here, sides are flipped, and it is Saudi Arabia that supports ruling regime while Iran supports Houthi rebels who are attempting to overthrow the Sunni government. However, these military operations both direct and indirect are very expensive. A Huge portion of the recent increasing military spending is connected with the Saudi Arabia's interventions and proxy wars (Khateeb, 2016). According to the Stockholm International Peace Research Institute (SIPRI), governmental spending on defence reached in 2005 27.4% of the entire governmental spending. It represents 13.7% of Saudi Arabia's GDP. It is third largest expenditures in the percentage of GDP. In the year 2015, Saudi Arabia allocated \$20 billion just for military operations in Yemen (SIPRI fact book, 2015). With decreased finances for the state budget, new austerity measures are being introduced. Waging proxy wars in Yemen and Syria is financially demanding. Military spending won't reach heights from the year 2008 when oil prices were around \$140 for the barrel. Supporting various Sunni groups across the region against Shia groups is a crucial strategy for Saudi Arabia for preserving their power. The Nuclear deal ( see section 4.3) led to an increase in Iranian power. As a result, enormous amounts of funds are being unfrozen, and investments are pouring into the country. This allows Iran to increase its military capabilities and boost support for their proxies. Saudi Arabia shares its fears over Iran with its GCC counterparts. Wehrey & Sokolsky (2015) argue that Iranian support for Bashar al-Assad regime in Syria, Houthi rebels in Yemen and Shia militias in Iraq added to unprecedented unity among the GCC members. Therefore, we see that it is an existential threat that brings Arab countries together and forces them to create strong alliances to survive. This evidence contradicts Barnett's

claims over pan-Arabism and shared identities that drive countries to cooperate.

### **3.4. Oil as strategic tool**

Oil producers often use oil as the strategic tool. Tactics like an over-flooding market with oil to decrease the prices and hurt geopolitical enemies were common policies of countries like Saudi Arabia (Jaffe & Ellass, 2015). Another example is oil embargo to cripple the enemy. In 1973 OPEC members issued oil embargo on the United States over their support for the Israel during Yom Kippur war. This period became known as the first oil shock. In the period from 1973 to 1974 oil prices quadrupled. When oil prices are high, oil countries tend to increase their spending on arms since a lot of funds are suddenly available (Jaffe & Ellass, 2015). By increasing production, Saudi Arabia previously aimed to force producers that are drilling expensive oil out of business and increase its overall share of the market and increase its revenues in the long run. However, recent development in the region and long lasting low oil prices led to revisit of this strategy and Saudi Arabia agreed to cut its production to survive.

## **Chapter: 4. The Game Has Changed**

Significant changes in the world contributed to the Saudi's willingness to cooperate with Iran. Prices were always volatile, what contributed to a recent shift in the approach? Simply put, the world has changed, and old methods how to deal with this will not work anymore.

### **4.1 Wars in the region, instability**

Wars and conflict in the neighbouring countries directly increase state budget of Saudi Arabia. However, according to the analysis of Peter Toft (2011), in the period of 1965 to 2007, he researched the link between interstate conflict and oil supply. In this period he looked at 39 civil wars in oil producing countries. He concluded that interstate conflict decreases oil supply around fifty percent of the time (Jaffe & Ellass, 2015). In Libya, for example, production decreased from 1 million in 2014 to 370,000 barrels per day in 2015. The armed militants attacked oil production sites in Libya to weaken the regime (Jaffe & Ellass, 2015). Therefore, potential conflict from neighbouring countries that could quickly spread to the eastern province of the Saudi Arabia, where a majority of the oil is produced could be catastrophic for the Saudi state budget. It could result in the lasting log decrease in the oil production and dramatically reduce state income. Saudi Arabia repeatedly intervenes into the internal problems of its neighbours such as Syria, Yemen, Bahrain, Libya and many others. Ironically, interventions that are being framed as counter moves against the hostile action of Iran to preserve the balance of powers can disrupt it. To support the Sunni governments across the region, Saudi Arabia increases hostility of the Shiite minority against the regime. This only adds up to the potential risk of unrests or terrorist attacks in the Eastern province.

## 4.2 Rise of the ISIL

The Islamic State of Iraq and the Levant (ISIL) is a Sunni terrorist organisation following the Wahhabi doctrines. ISIL successfully controls part of Iraq, Syria, and Libya. One might argue the success of ISIL especially in the Shia-led Syria might be in the interest of Saudi Arabia. ISIL even follows the Wahhabi doctrines that are deeply connected with the Saudi Arabia. However, not only ISIL fights also against the Saudi Arabia allegedly over its alliance with the West. Saudi Arabia was also repeatedly targeted by the terrorist attacks perpetrated by the ISIL. The main problem is that it contributes to the destabilisation of the neighbouring countries that is successfully being used by the Iran and its proxies. ISIL emerged from the weak states, and it is very unlikely that it will directly spread to other countries (Walt, 2015). Abilities of ISIL to create problems in other nations is clear, and states will take measures to prevent a similar scenario when weakened regimes lost control of their territories (Walt, 2015). In 2015 Walt argued that it is Saudi Arabia and other neighbouring countries that have a lot at stake. In his article, he discussed the possibility of ISIL “normalising” into the proper state. Luckily, this possibility seems much more unlikely than in 2015. However, the point remains that it is in the interest of the neighbouring countries to defeat ISIL. Saudi Arabia formed the Islamic coalition against ISIL. It consists of 34 Islamic countries dedicated to eliminating this terrorist organisation. It is especially in the interest of Saudi Arabia to bring stability back to the Iraq to regain control over lost territories and decrease the influence of the Iran. Around 90% of the entire oil production come from the eastern province of the Saudi Arabia. This area is also predominantly Shiite. Wahhabi Islam perceives Shiites also as their enemies. Wahhabi ideology claims that Shiites deviated from “pure” form of Islam. The Eastern province, therefore, represents an ideal target for the ISIL. By attacking Eastern Province, the potential attack will strike bot, the Shiite minority that is being perceived as the diversion from the pure form of Islam and Saudi Arabia that is being supported by the west. Rising expenditures over domestic security are also connected to the fact that in 2014 estimated 2500 citizens of Saudi Arabia joined ISIL. It is second largest support for the group in terms of total numbers (The Soufan

Group, 2015). Extremist groups take advantage of the weakness of the state and strengthen their position. In Libya ISIL and al-Qaeda already control parts of the Libya with important infrastructures such as oil pipes, oil wells, airbases, and military wear houses. (The Soufan Group, 2016, p. 5). Using Libya as the base for training of the fighters poses threat to neighbouring countries and region as a whole (The Soufan Group, 2016, p. 17).

### **4.3 Iran nuclear deal**

On July the 14th, 2015 Permanent Members of the United Nations Security Council and Germany (P5+1) reached an agreement with Iran on the Joint Comprehensive Plan of Action (JCPOA) also known as the Iran nuclear deal. This deal significantly increases the time necessary for Iran to develop nuclear weapon also known as the “breakout time”. It decreased low enriched uranium by 98% from previous 10,000 kg to 300kg, medium-enriched uranium by 100% from the previous 196kg to 0kg. Iran will reduce the number of the oldest “first generation” centrifuges from 19 000 to 6000. Advanced centrifuges with increased efficiency will be decreased by 100%. All the enrichment procedures were agreed to occur only at the Natanz plant. Iran vowed not to build any new enriching facilities for 15 years. International Atomic Energy Agency (IAEA) will triple its inspectors from current 50 to 150 over sighting entire supply chain of the nuclear program. (Joint Comprehensive Plan of Action, 2015). In exchange, the international sanctions imposed on Iran were lifted. The main concern of the Gulf countries, regarding the nuclear deal, is Iranian use of the new capital. The Gulf countries are less concerned about Iranian nuclear program and more with its geopolitical plans. Especially with the recent increase of the Iranian influence over the region (Ibish, 2015). As a result of the deal, an economy of the Iran will significantly improve. The immediate result of the sanction was the release of the frozen assets, up to \$107bn. The World Bank estimated that sanctions reduced Iranian exports by \$17.1bn during 2012-2014 (Devarajan & Mottaghi, 2015). Exports are expected to increase rapidly. Up to \$50bn of Foreign Direct Investments (FDI) are projected to pour into Iranian economy following the deal (Motevalli,

2016). Hassan Rouhani, president of Iran conducted series of official state visits across the Europe. Hassan Rouhani signed contracts on behalf of Iran with the European companies. Iran reached a deal with the French PSA Peugeot Citroën worth 300million Euro and Italian steelmaker Danieli worth up to \$6.2bn. Besides these deals Iranian and Italian companies also signed deals worth \$18.36bn (Meichtry & Wall, 2016). The need for modernisation in the aviation sector resulted in agreements with Boeing for 80 aircraft worth \$16bn and with Airbus over 100 A330 models (Motevalli & Kamel, 2016). Iran also re-entered the oil market. Significant investments are expected in this sector since Iran decreased its production because of the sanctions. The oil sector is expected to rise since a majority of the oil reservoirs are unused. First economic sanctions were imposed by the United States in 1979. However, Iran managed to keep growing and diversifying its economy despite the sanctions. The Iranian economy is one of the most advanced and diverse economies in the region with 70% of the revenues coming outside of the oil sector (Young, 2015, Beydoun & Zahawi, 2016). This makes Iran less dependent on the oil price and less vulnerable to its volatility. Potentially allowing Iran to use oil as the strategic tool once again. The 45th President of the United States during his campaigning repeatedly criticised Obama administration for the Iran nuclear deal. However, repeal of the deal is very unlikely, and even if the US decides to re-impose sanctions under Trump administration, the European Union will not.

## **4.4 Changes in the leadership**

### **4.4.1 United States**

Changes in the leadership of United States affects the region and Saudi Arabia both directly and indirectly. Military operations, general stance on the relationship and strategy depend on the president. The United States also significantly affects oil prices. In 1975, following first oil shock as result of the Arab oil embargo, the Congress adopted the Energy Policy and Conservation Act (EPCA) (S.622-94th Congress, 1975), that banned oil exports from the US. This act also began with a policy of increasing energy efficiency of the United States. However, economic

growth of the United States led to increased consumption of the oil, and besides the effort, the increasing self-sufficiency United States became a major importer. This ban was lifted under Obama administration, when it passed Congress on 18th December 2015 (The Economist, 2015). Demand for the oil import is slowly decreasing in the US as production is rising and it can meet its needs. However, this bill might increase overall oil production and contribute to another decline in oil prices in the future (The Economist, 2015). The Obama administration was also very vocal about energy efficiency and power consumption to protect the environment. In 2011 United States adopted a goal to reduce oil imports by one-third by 2020. The goal was elevated in 2012 to reduce imports by half in 2020 (Furman & Spering, 2013). There is very little known about nature of the Trump Administration; however, one thing is very likely to happen, and that is increased support for the oil sector. Oil sufficiency in the United States might significantly increase in the next four years. His cabinet picks, initial executive orders and official statements they indicate that he will be relying a lot on the energy sector, particularly the oil production. For example, Trump appointed Rex Tillerson as his Secretary of State. Previously, he worked as chief executive officer (CEO) of Exxon Mobil, largest publicly traded international oil and gas company. Exxon Mobil is listed as a second company in the world based on the revenue income (Fortune, 2016). President Trump released memorandum regarding resuming construction of the Keystone XL and Dakota Access pipelines that were stopped by Obama administration due to the widespread protests (Trump, 2017). There is a section named “Top Issues” on the official website of The White House. Among them is “An America First Energy Plan” where Trump administration outlines plans and vision for next few years. Here, president criticises regulations on the oil industry. By reversing several Obama’s policies such as Climate Action Plan and the Waters of the U.S. new administration aims to boost oil production. They intend to use reserves that government claim are in the value of approximately \$50 trillion. And mainly to achieve energy independence from the “OPEC cartel and any nations hostile to our interests” (An America First Energy Plan, 2017). All of these policies will add up to the oil supply that will significantly increase and affect world oil prices.

On January 29 President Trump spoke with King Salman. However, White House claims that new executive order wasn't discussed. This executive order suspends US refugee admission system for 120 days, restricting admission of Syrian refugees indefinitely, It prohibits entry for citizens from seven predominantly Muslim countries for 90 days. (Trump 2017). It affects approximately 200 million Muslims. Several Islamic countries already condemned this action. However, Saudi Arabia remains silent on this behalf. King Salman also holds an ancient title, Custodian of the Two Holy Mosques that was for centuries held by Islamic rulers. It represents King's resolution to protect two holy places. One of the two holy mosques is the Sacred Mosque in Mecca, towards all Muslims turn during their prayers. The reason why Saudi Arabia and King Salman refuse to condemn this action is that they need the support of the United States for their Vision 2030. The United States also sell weapons to the Saudi Arabia.

#### **4.4.2 Saudi Arabia**

With the death of King Abdullah Al-Saud and rise of the new Saudi King, policies, and orientation of Saudi Arabia started to change. Rising powers of young deputy crown prince Mohammad bin Salman Al-Saud and his visions for modernisation significantly affected foreign policy and possible spoiled effects of oil pressure on decision making. On another hand, one of the primary goals of the new leadership is to diversify and modernise the economy. He swiftly rose inside the ranks and gained power through ministries. Currently, he is a minister of state, minister of defence, secretary general of the Royal Court but also as the chair of newly established Council for Economic and Development Affairs. This gave him control over the state-owned oil company Saudi Arabian Oil Co (Aramco). It is partial privatisation of the Aramco that plays a significant role in his plan of modernisation.

## **Chapter: 5. Reform**

Mohammad bin Salman Al-Saud's strategy, Vision 2030 is articulated in the National Transformation Plan another economic strategy that was previously adopted. Vision 2030 is economic reform of the Saudi Arabia that plans to diversify the economy from the oil in 15 years. Among many other Vision 2030 goals, there is a goal to increase non-oil revenues from SAR 163 bn to SAR 1 trillion, increase government effectiveness index from current 80 to 20. Increase private sector contribution to the GDP from 40% to 65%. Increase Public Investment Fund assets from SAR 600 bn to over SAR 7 trillion. Increase FDI, increase women participation in the workforce, lower unemployment and improve small and medium enterprises (SMEs) contribution to the GDP (Saudi Vision 2030). And to reduce subsidies for water, in order, that cost of the water represents 100% of the expenses from current 30% (Feteha, Nerim & Mahdi, 2016). Enormous governmental expenditures are expected. Not only the direct cost of the reform itself but also with its implementation. This reform plans with partial privatisation of the state-owned Aramco, to raise the capital necessary for the implementation. (World Bank, How is Saudi Arabia reacting to low oil prices? 2016). As mention in the previous chapter, King Salman and Saudi Arabia as a whole is silent about the recent executive order that prohibits entry of certain nationalities. It is due to Saudi Arabia rely on America, even with the new administration over its security but also reform itself. Successful implementation of this reform would lead to the stronger position of the Saudi Arabia both internally and externally. It would result in less volatile economy, more stable and predictable income would allow for better budget planning. Last but not least, it would allow Saudi Arabia to again use oil as the strategic tool without having its major effects on themselves. This reform poses a potential risk from the conservative clergy. Radical reforms led to revolution in Iran being led by the clergy when country was weakened and citizens unhappy (see chapter 1.2). Reforms in Saudi Arabia needs to be implemented with caution to avoid Iranian scenario.

## **Conclusion and discussion**

The oil sector dominates the economy of the Saudi Arabia. Income from this sector represents 90% of the state budget. However, oil prices are extremely volatile. In the period of 2014 to 2016 prices fell by 80%. To the volatility adds inelasticity of both, demand and production, use of the oil for investments, global geopolitical and economic events. However, most recently significantly affected this volatility technological advances. This uncertainty of the oil prices is reflected in the WOO where a difference between two forecasted predictions is 11.1mb/d. President of the United States, Donald Trump and his support for the oil sector might even further decrease world demand. During recent price drop, Saudi Arabia hit record state deficit of \$98bn. It is estimated that oil prices around \$105.60 are needed to balance the budget. More than twice of the current prices. The state deficit is also the result of the massive subsidy program by which government maintained their power. By nature of the regime, monarchy prevents new businesses to emerge. It is a royal family that controls a majority of the companies. Saudi Arabia is ranked as a 94th country out of 190 in ease of doing business in the country.

Arab Spring revolutions in 2011 resulted in increased governmental spending on the defence. While the budget for security is annually rising by 19%. It is Eastern province of the Kingdom where Shia Muslims lives. 90% of the proven oil reserves are in this province. Saudi Arabia is using sectarian conflict as tool how to polarise society and avoid unified opposition. The Shiite minority is being suppressed. Alongside with rising Iranian support for the Shiite groups and increasing instability in the neighbouring countries Saudi Arabia witnessed an enormous increase in the terrorist attacks. In 2015 up to 103 terrorist attacks occurred. Compared with the year 2014 where only 14 attacks occurred it represents 735% increase. Kingdom competes

with Iran over a sphere of influence through their proxies. Saudi Arabia is waging proxy wars in Syria, Iraq, and Yemen. In 2005 spending on defence reached 27.4% of the entire budget. It represents 13.7% of the GDP, and it is third largest expenditures in the world. Only in 2015, Saudi Arabia allocated \$20bn for direct military operations in Yemen.

One of the most significant events was Iran nuclear deal. The sanction lift unfroze up to \$107bn. Sanctions decreased Iranian export revenues by \$17.1bn and significantly reduced their oil production. As a result, Iranian GDP is expected to rise by 5.2% in 2017. The primary concern of Saudi Arabia is how will be these funds used. Kingdom fears use of these resources for increased support of the Shiite groups and Iranian proxies. Deputy Crown Prince Mohamed Ibn al-Saud introduced Vision 2030. This reform aims to diversify the economy from the oil in 15 years. It plans non-oil revenues from 163bn to 1 trillion SAR, that is 613% increase. To increase the contribution of the private sector to the GDP by 25% and decrease spending on the democracy, it aims to improve government effectiveness index from 80 to 20. Most financially demanding is an increase of the public investment fund assets from current 600bn SAR to 7trillion SAR, that represents 1166% increase.

Saudi Arabia is facing a new reality. The World is changing, and due to the technological advances, oil becomes a less important commodity in the current world. The Saudi economy is heavily relying on the income from the oil revenues. Oil prices are extremely volatile resulting in enormous changes in the state budget over the years. Power position of Saudi Arabia is being threatened by rising threat of the terrorist attacks, unrests in the eastern province. State budget expenditures are also increasing due to the military operations in Yemen, Syria, and Iraq. To continue fighting its external enemies, Saudi Arabia was forced to adopt austerity measures. However, Saudi Arabia for years provided its citizens economic benefits as part of the “social contract” in exchange for the total obedience. The decrease in these benefits might result into unrests and protests and eventually crippling the country and weaken the Kingdom even more. During the Arab Springs, Saudi Arabia increased its subsidy

program and increased its restrictions over a Shiite minority. Even with the current austerity measures is this system unsustainable. To balance the budget, oil prices would need to double. Saudi Arabia is also facing an external threat from Iran. Internal threats from unsatisfied citizens, terrorists, and political opposition need to increase its revenues to keep order in the country. As the result Vision, 2030 was introduced. Program to reform economy of the country, decrease governmental spending and increase revenues by diversifying the economy and supporting private companies to enter the market. This reform requires massive governmental spending, Saudi Arabia plans to gain funds through partial privatisation of the state-owned oil company. Successful implementation would eventually result in increased Saudi power. This careful calculation of risks and benefits led to OPEC deal that was reached on 30th of November 2016. In the short run, it gives a certain economic advantage to the Iran that can be used against Saudi Arabia. However, in the long term this minor increase for the state budget can significantly strengthen the kingdom. This deal represents the willingness to overcome ideological, in this case, sectarian differences, to increase power position of Saudi Arabia. This thesis has proven that even countries with strong ideological positions are willing to cooperate with its enemies when their power position is being threatened.

## Resumé

Práca sa venuje rozhodovaniu v krajinách, kde ideologické postoje hrajú veľkú úlohu. Autor sa zaoberá otázkou, kedy sú tieto krajiny ochotné prekonať svoje ideologické postoje. Práca analyzuje nedávnu dohodu z 30. novembra 2016, kedy sa členovia Organizácie krajín vyvážajúcich ropu (OPEC) dohodli na znížení výroby. Saudská Arábia súhlasila so znížením vlastnej produkcie o 0.4 milióna barelov ropy a navýšením produkcie Iránskej Islamskej Republiky. Práve Irán je najväčším geopolitickým nepriateľom Saudskej Arábie. K výberu týchto krajín ako prípadovej štúdie prispela aj miera ich ideologického presvedčenia. Obe krajiny otvorene hlásajú popredné postavenie islamu v krajine. Práca predpokladá, že krajiny sú ochotné prekonať ich ideologické presvedčenia, keď je ich prežitie v ohrození a ich regionálna pozícia sa oslabuje. Mnohým pozorovateľom by sa mohlo zdať, že práve toto konanie, kde krajina súhlasí s relatívnym zvýšením sily svojho nepriateľa, ako iracionálne. No autor v tejto práci dokazuje na základe teoretického modelu realizmu, a to konkrétne práci Hansa Morgenthaua, že ide o racionálne rozhodnutie, ktoré je výsledkom dôslednej kalkulácie možných rizík a ziskov.

Prvá kapitola sa zaoberá náboženskou otázkou oboch krajín nakoľko je to práve rozdielna interpretácia Islamu, ktorá je prezentovaná ako hlavný dôvod ich nepriateľstva. Táto kapitola sumarizuje vznik Iránu a Saudskej Arábie, náboženstvom v oboch krajinách, ako aj Arabskou jarou.

V druhej kapitole autor opisuje už spomínanú dohodu z 30. novembra, ktorá viedla k zníženiu produkcie ropy v Saudskej Arábii a zvýšením v Iráne.

Prvá časť tretej kapitoly analyzuje ekonomiku Saudskej Arábie. Autor popisuje dominantnú úlohu ropy, ktorá tvorí až 90% podiel príjmov krajiny. Práve dominancia tohto sektoru je jedným z dôvodov prečo Saudská Arábia pristúpila na dohodu. Prepád cien viedol k rekordnému deficitu v štátnom rozpočte, ktorý dosiahol v roku 2015 \$98 miliárd. Vo zvyšku tretej kapitoly autor analyzuje zmeny v cenách ropy, ich dopady na rozpočet a možné vnútorné a vonkajšie dopady. Ceny ropy citlivo reagujú na globálne geopolitické a ekonomické udalosti. K nestálosti cien ropy taktiež prispieva fakt, že produkcia, ako aj dopyt, sú extrémne neelastické, teda pomaly reagujú na zmeny. Táto nestálosť sa prejavuje aj v predpovedi OPECU, kde je načrtnutých niekoľko predpovedí. Rozdiel medzi tou najoptimistickejšou a najpesimistickejšou dosahuje 11.1 milióny barelov denne. K už tak náročnému odhadu pribudli aj environmentálne politiky krajín, výrazný technologický pokrok vo

výrobe, a najmä automobilový priemysel, prispeli k náročnosti predvídateľnosti cien ropy.

Saudská Arábia, ako mnohé iné krajiny s ropným bohatstvom, využíva tieto zdroje na dotácie pre obyvateľov výmenou za ich podporu. Znížením príjmu bola Saudská Arábia nútená znížiť tieto dotácie a po prvý krát zaviedla daň z pridanej hodnoty. Saudská Arábia zvyšuje svoje výdavky na bezpečnosť nakoľko sa zvyšuje riziko teroristických útokov ako aj hrozby nepokojov vo východnej časti krajiny. Od revolúcií počas Arabskej jari v roku 2011 stúpa každoročne obranný rozpočet o 19%. Okrem výdavkov na vnútornú bezpečnosť, krajina podporuje rôzne ideologicky blízke skupiny na Blízkom východe. Podporou týchto skupín sa snaží zachovať alebo získať vplyv na vývoj v krajine. Irán, ako aj Saudská Arábia, medzi sebou bojujú pomocou týchto skupín v Iraku, Jemene a Sýrii. Saudská Arábia je krajinou s tretím najvyšším rozpočtom na obranu. V roku 2005 to bolo 27% z celkového štátneho rozpočtu, čo predstavuje 13.7% celkového hrubého domáceho produktu. Len v roku 2015 krajina vyčlenila \$20 miliárd na vojenské operácie v Jemene.

Ceny ropy boli vždy premenlivé, no Saudská Arábia prvý krát pristúpila na otvorenú kooperáciu s Iránom. Práca v štvrtej kapitole popisuje zásadné zmeny na Blízkom východe, ako aj vo svete, ktoré zmenili situáciu krajiny. Nestabilita susedných krajín, aktivity Islamského štátu, ale aj voľba nového amerického prezidenta prispeli k tomuto kroku. Obrovským faktorom bola aj dohoda medzi Iránom a stálymi členmi bezpečnostnej rady Organizácie Spojených národov a Nemeckom (P5+1). Irán sa výmenou za zrušenie medzinárodných sankcií vzdal časti svojho nukleárneho programu. Irán zrušením sankcií získal okamžitý prístup k zahraničným aktívam v hodnote \$107 miliárd. Odhaduje sa, že sankcie znížili export Iránu o \$17.1 miliárd a očakáva sa navrátenie do pred sankčných hodnôt. Krajiny povolili svojim investorom investície v Iráne ako aj celosvetový predaj iránskej ropy. Saudská Arábia sa obáva využitia týchto príjmov a to hlavne v Sýrii, Jemene a Iraku. Irán svojou produkciou taktiež dokáže výrazne ublížiť rozpočtu krajiny. Aj pre tieto dôvody zastupujúci korunný princ Saudskej Arábie Mohammad bin Salman Al-Saud predstavil reformu 2030. Plánom reformy "Vízia 2030" je diverzifikácia ekonomiky do pätnástich rokov. Reforma vyžaduje obrovské štátne výdavky. No úspešná reforma môže výrazne zvýšiť regionálnu silu krajiny.

Práca dochádza k záveru, že krajiny so silnými ideologickými postojmi sú ochotné ich prekonať, keď je ich prežitie a postavenie v regióne ohrozené. Prípadová štúdia Saudskej Arábie a Iránu opisuje ako dominancia jedného sektora, nestabilné ceny ropy, regionálne zmeny, technologický pokrok, ako aj narastajúce výdavky na obranu a bezpečnosť, ohrozujú prežitie krajiny. Krajina predstavila reformný program, ktorý

ale vyžaduje čas a vládne investície. Práve toto viedlo Saudskú Arábiu aby spolupracovala s Iránom a získala tak financie na realizáciu reformy. Dočasnou spoluprácou si udržia svoju pozíciu a dlhodobo zvýšia svoju regionálnu silu.

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