

Bankers Trust Company



Country Assessment

International Economics

280 Park Avenue, New York, N.Y. 10017 U.S.A.

POLITICAL ENVIRONMENT REPORTING FORMAT

William H. Overholt
Vice President
Political Assessment Group

PAG 99/4-D 19 November 1982

DRAFT

This is a working document and is not in final form; the statements contained in it may need to be revised or corrected. It is reproduced for private circulation only, not for general distribution or publication, and it should not be cited or quoted without the permission of the author.

Drafts are reproduced at the discretion of the author, with no Bank review procedure, and thus no opinions, statements of fact, or conclusions contained in this document can be attributed to the Bank or its clients.

POLITICAL ENVIRONMENT REPORTING FORMAT

I. The Government

A. Top Leadership.

Who are the top leaders (e.g., president, cabinet party leaders, military leaders, private influentials)? What do we know about their backgrounds, priorities, integrity, egalitarianism and interrelationships with each other?

- Are they highly skilled technocrats, or ideologues, or religious leaders, or what?
- Are they personally honest or corrupt? able or unprepared? decisive or vacillating?
- What is their knowledge and perception of economic affairs? What priority does economic policy have in their development strategy? What political and economic goals have they set themselves?
- Is the leadership unified and tightly knit (personal relationships, ideology, interests) or fragmented?
- What would happen if key leader(s) disappeared?

B. The Government's Institutional Base.

What institutions (legislature, key bureaucratic agencies, governing party, military, interest groups) must implement the top leadership's policy goals?

- What is the quality of personnel below the top levels?
- Can the bureaucracy implement policy?
- Are key institutions coordinated or divided (e.g., executive vs legislature)? Give examples.
- Has the institutional structure responded well to past crises? Give examples.

C. Social Groups.

What social groups (e.g., military clergy, workers/labor movement, businessmen, middle class, farmers/peasants, ethnic/language groups) affect the implementation of government policy or the possibility of political change?

- Which groups are politically active and organized, and which are not? Are some becoming active and organized? Why?
- From which groups does the government derive its support? Why?
- To what extent do they hinder the implementation of government strategies or policies? To what extent do they reinforce opposition strategies?
- Note: In order to judge the willingness of a given social group to support the government, one should interview members of the group, and one should make judgements about the political and economic benefits the group is receiving from the regime and is likely to receive in the future.

II. The Opposition

A. Within the Regime.

What are the opposition factions within the top leadership, government institutions, the formal opposition; and what groups are pressing for a change in the system?

- Could factions within the governing group or the legal opposition come to power and implement significantly different policies?
- In particular, do opposition factions focus on economic policy? What economic policies would they implement if they came to power? What would be their attitude toward the U.S. and U.S. banks and corporations?

B. Outside the Regime.

- Are there groups pressing for change in the system (e.g., through coup, revolution, or drastic constitutional change)?
- What is the quality of leadership of such groups and what are the goals of groups pressing for system change?
- How organized and unified are such groups? What is the quality of their institutions?
- What is their social base?
- What economic and other strategies are opposition groups using to defeat the current system? What counter strategies is the government using? What are the possible outcomes?

III. Economic Management

- Will political pressures inhibit vitally needed economic measures?
 - devaluation
 - pricing changes
 - subsidy reductions
 - investment reductions
 - investment redirection
 - indexing changes
 - reduced protectionism
 - reduced corruption

- Will likely political or economic changes (see sections V, VI) create pressures for better economic management by existing leaders, or bring to power individuals or groups more committed to effective management?

IV. International Environment

Do conflicts with foreign powers (especially neighbors or big powers) endanger the country's political or financial viability?

Would friendly foreign nations (especially big powers) bail the country out of a political or financial crisis?

Could business with this country adversely affect business with other countries?

What attitudes has the country taken on North-South issues, especially proposals for debt cancellation? Have the leaders warned that debt problems are primarily caused by outside powers and that their own responsibility is therefore limited?

Are there particular problems with the U.S. which could lead to political retaliation against a U.S. bank? (Note Iran)

Are there other international conflicts (note Argentina vs. Britain) which might lead to a freeze of assets?

V. Pressures for Political Change; Danger Signals

What are the economic, cultural, international, or internal political trends likely to change the structure of the regime, its policies, the structure of the opposition or the relationships among them?

- What are the major strains or conflicts in the current system that will have to be resolved? What happens if they aren't?
- How does economic performance (or pressures) feed back to change the goals and strategies of the government or of opposition groups?
- What are the most dangerous international issues?
- What is the most likely alternative to a "business-as-usual" scenario?
- What two or three events would you pinpoint as early warning signals that significant change was likely to take place?
- Are there events (surprises) which are unlikely but not impossible (e.g., war, assassinations) which could greatly alter the country's prospects?

VI. Kinds of Change

If change is likely, will it likely affect:

- leaders?
- important policies?
- institutional structures?
- the nature of the regime?
- the ability of the country to maintain liquidity?

Do any of the likely or possible changes endanger potential business relationships or heighten risks?

Might political change bring (true or false) allegations that certain deals entered into, or guaranteed by, the government were invalid, corrupt, or personal rather than official? Might such allegations undermine key firms or arrangements of business significance?

What kinds of business might be improved by the changes?

What kinds of business would be unaffected by the changes?

VII. Style and Focus

The report should be extremely concise.

Throughout, it should focus on the specific publications for business.

Sources of evidence should be briefly noted wherever this is not obvious ("Discussions with Peronist leaders indicate ...")

**Bankers Trust
Company**  **Country
Assessment**

International Economics

529 Fifth Avenue, New York, N.Y. 10017 U.S.A.

THE STABILITY OF SAUDI ARABIA: EXECUTIVE SUMMARY

William H. Overholt
Vice President
Head, Political Assessment Group

PAG 87/3-D

5 November 1982

DRAFT

This is a working document and is not in final form; the statements contained in it may need to be revised or corrected. It is reproduced for private circulation only, not for general distribution or publication, and it should not be cited or quoted without the permission of the author.

Drafts are reproduced at the discretion of the author, with no Bank review procedure, and thus no opinions, statements of fact, or conclusions contained in this document can be attributed to the Bank or its clients.

THE STABILITY OF SAUDI ARABIA

Executive Summary

Saudi Arabia is a sea of sand the size of India with an indigenous population about half of New York City's. Its oil reserves, and more importantly a production capability equal to about half of current OPEC production, currently yield it a dominant position in OPEC. Its estimated \$150-180 billion reserves yield huge potential (but unused) leverage over the global financial system. Its huge construction projects make Saudi contracts a crucial margin for many of the world's great construction, architecture, and urban planning firms, and worker remittances from Saudi Arabia have become a critical balance of payments margin for many Asian countries.

Saudi Arabia's rise to modernity is very recent. Slavery was abolished only in 1962. About half the population is still illiterate. The government is a monarchy run by the sons of the nation's founding father, Abdul Aziz. A generation ago, the camel raid was the predominant domestic economic activity, and foreign exchange came largely from dates, pearls, and pilgrims.

There is an almost universal perception that Saudi Arabia must be unstable because it is a fast-growing, oil-rich, Islamic country like Iran and because other monarchies have largely failed to survive the twentieth century. However, Saudi Arabia has far more money per capita than did Iran. Saudi Arabia's Wahhabi version of Sunni Islam marries religion to the state, whereas Iran's Shi'a Islam opposed religion and state. The Saudi royal family of 4,000 princes, dispersed into three major cities, is far less vulnerable to a coup than was Iran's Shah. And Saudi Arabia's relatively homogeneous indigenous population is more cohesive and easier to manage than Iran's diverse ethnic groups.

Unlike Iran, and unlike most other monarchies (ancient France, China, Russia, modern Ethiopia), Saudi Arabia largely lacks a peasantry vulnerable to uprooting by market forces and therefore susceptible to revolutionary discontent; instead, the nomadic bedouin is already familiar with the market and often finds his first geographic roots through inducement by massive subsidies to settle in the towns. Likewise, Saudi Arabia's middle class is currently not a frustrated and deprived revolutionary force; it is getting rich fast. The military, a key threat to other monarchies, is divided, immobile, and weak.

Saudi Arabia's economic and political management have severe problems, but so far represent an impressive achievement given the primitive conditions from which the current administrative system has germinated. The Saudis aim for oil prices which will generate a high income, but not create excessive incentives to diversify away from oil. They invest their surpluses conservatively. They recognize a stake in the general health of the global financial system and the global economy. At home the regime concentrates investments on

infrastructure, diversification, human resources, and security, and has succeeded in eliminating major bottlenecks and in taming formerly serious inflation. At the same time, given weak administration and pre-modern concepts of patronage, the country's landscape and recent history are strewn with many of the world's most spectacular examples of mismanagement and corruption.

Perhaps, more important, the flow of funds may now stabilize or even decline somewhat, rather than growing exponentially. This, together with rising competition, will mean a major economic shakeout -- and perhaps more politicized competition for shares of the economic pie. If oil revenues decline, due to production and price cuts, this shakeout could become severe, with ramifications first for the viability of key businesses and later for Saudi politics. The regime nearly ran out of money in 1978, despite enormous revenues, so this outcome is not at all impossible.

The regime has mediocre top leadership, but employs consensus-style decision-making in a way which usually ensures through consideration of issues and broad assent to key decisions. The decision-making system is vulnerable to breakdown in a crisis. The senior princes are competitive, but the family has demonstrated an ability in the past to constrain competition within bounds and (with difficulty) even to remove an incompetent king. However, there is a great social gulf between the senior princes, none of whom was educated abroad, and the junior princes, most of whom have Western educations. The Saudi bureaucracies are ably and dynamically led, often by relatively young technocrats, but beneath the top are an administrative morass. The most fundamental deep social split is the one which could arise between technocratic younger princes and executives, on the one hand, and traditionalists on the other. Now, the technocrats are dazzled by new and expanding wealth, but if oil prices remain high they will come to take it for granted and if oil prices decline there may be some epic struggles for control. The young princes, the technocratic executives, modern military officers, and women could one day seek to change the system.

The Saudi government has a broader social base than many of its neighbor monarchies and predecessors had, because of the extent to which the Saud family has intermarried with diverse tribes and because the royal family has successfully achieved acceptance as upholders of the Wahhabi faith. It also gains from its ability to distribute the oil wealth. Conversely, its key social vulnerabilities among the majority of Arabians focus on: the risk that someone could seize one of the holy cities (Mecca, Medina, Damascus) or make the regime seem inadequately attentive to its duties regarding the fourth holy city, Jerusalem; the risk that large groups would accuse the government of modernizing at the expense of religious faith; and the risk of declining oil income.

Change has created severe social strain over identity (is tribe, nation, or the international Arab cause central?), the use of interest and insurance and modern taxes, the role of women, the permissibility of technologies such

as television, and many others. However, the regime tries to stay on the conservative side, allowing an innovation like television to emerge, then pulling back sharply when there are too many protests, then quietly allowing its fuller emergence as a social consensus forms. Despite the takeover of the Great Mosque in November 1979 by fundamentalists, such cultural pressures will not by themselves create adequate discontent and organization to overthrow the regime; the strain is a resource to be drawn upon in connection with other issues. Those issues could be national humiliation or an economic struggle.

Saudi Arabia is home to enormous resident minorities who perform most manual labor, most low-level service jobs (such as hotel clerks), a considerable amount of administration, and much high-level business. Many of these do not threaten the regime. The Westerners mostly live in gilded ghettos and lack roots. The Filipinos, Thais, Koreans, and Indians similarly seek to earn a nest egg and depart, while having little to do with Saudi Arabian society. The Palestinians cannot be expelled, but are not so numerous in Saudi Arabia as elsewhere in the Gulf, and the Saudis have prevented them from organizing; the Palestinian problem with Israel can destabilize Saudi Arabia, and the Palestinians can destabilize Saudi Arabia's neighbors, but the Palestinians inside the country will not lead a revolution. The Pakistanis and Egyptians lack political organization, but could serve as transmission belts of a new Nasserite ideology if one should arise elsewhere; their important role is intellectual leadership (and, in the case of Pakistani troops, service as a palace guard).

The serious minority problems are the Yemeni and the Shi'ites. The combined populations of North and South Yemen (8 million) are nearly double Saudi Arabia's, and some 2 million Yemenis work in Saudi Arabia. They are skilled, hard working, and easily organized, and they are resentful of the historically inferior Saudis' power and of the latter's seizure in 1934 of Asir and Jizan provinces. Fighting between North and South Yemen, or civil war in North Yemen, could draw Saudi Arabia in. A united hostile Yemen would be a major threat. These possibilities are not unlikely in the five to twenty year period.

The Shi'a minority in Eastern Province are oppressed religiously and economically underprivileged despite recent improvements. They rioted severely in November 1979 and February 1980. They constitute 50-80 percent of the oil field work force and include 150,000 males between 15 and 22, the prime ages for political dissidence. They know that attack on the oil facilities would destroy their livelihood, but a tiny group who felt religious freedom more important than economic well-being could potentially destroy oil production for a considerable period of time through a single well-aimed attack.

Internationally, Saudi Arabia is a great financial and energy power, but a helpless midget militarily and demographically. It is tied into all the great conflicts of the Middle East because the majority of its people identify themselves with the Arab cause against Iran and against Israel. First, with Iran potentially a victor over Iraq, Saudi Arabia and the Gulf countries will have

to pay a price for their increasingly visible support of Iraq. While the siren song of Khomeini does not attract the Saudi majority, it could stimulate movements and riots in Bahrain or in Eastern Province. While economic chaos diminishes Khomeini's attractiveness, victory over Iraq will increase it; the risk for Saudi Arabia is enhanced somewhat by the Saudis' support of the probable loser. Second, the anger of other OPEC countries at Saudi oil decisions can create risks: in 1979, several OPEC countries warned Saudi Arabia that its "overproduction" would lead to retaliation within a specified time period, and oilfield explosions did occur during that period. Third, and most importantly, public humiliation by Israel could bring down the regime, if the regime cannot avoid being discredited by the argument that its American connection represents a sell-out of the Arab cause.

In short, Saudi Arabia has impressive political and social strengths compared to most other monarchies, and its administration, while in many ways corrupt and inefficient, has come a long way in the last generation. But it is still a one-commodity economy, a desperately small and militarily impotent country, a polity with limited ability to manage a crisis, and a regime whose legitimacy depends upon protecting holy cities beyond its control and maintaining fundamentalist righteousness in the face of modernization. In short its strengths must be balanced against key risks:

In the one-to-five year period:

- A tiny Shi'ite or fundamentalist group could blow up key oil facilities and drastically reduce production for a year. The consequences could easily bring the regime down.
- Iran could try to accomplish the same goal, as part of the denouement of the Iran-Iraq war, or as part of a subsequent conflict based on Shi'ite coups elsewhere in the Gulf. Reportedly a commando team with such goals is currently operating in the country.
- In reaction to the Iranian-supported attempted coup in Bahrain during December 1981, Saudi Arabia has now stationed troops in Bahrain. If these became involved in suppressing an Iranian-supported coup, there is at least some risk of Iranian retaliation against Saudi oil facilities.
- Libya or another disaffected oil producer could sabotage the oilfields in an effort to raise prices, in a more decisive version of May 1979.
- Bitter humiliation by Israel could bring domestic charges that Saudi ties to the U.S. were tantamount to ties with Israel and therefore treason. The regime would have to try to save itself by making conspicuous deals with the Soviet Union, greatly reducing oil production and perhaps embargoing the U.S., and forbidding most future business relationships with U.S. firms. There are many scenarios with such results.

- A new Nasserite ideology arising in Egypt, post-Saddam Iraq, or post-Assad Syria could mobilize technocrats, women and youth; the enthusiasm for Nasser in his day is hard to overstate and there is a yearning for a new socialist, pan-Arab ideology which would somehow combine Islam and modernity.

In the four-to-ten year period:

- Over the longer run, if the country avoid the above short-term scenarios, an eventual technocratic coup led from within the royal family is a serious possibility; if the short-term difficulties materialize, or if oil prices fall dramatically, this could occur within five years. Such a coup could be quick, decisive, and unimportant for business, or it could be violent, protracted, and nasty for business. The timing of a technocratic coup, which is likely sometime in the 1980s, will be affected by: the extent to which the military becomes stronger and more unified; the extent of the forthcoming economic shakeout, which will for the first time in recent years create a severe competition for shares of the pie; and the occurrence of humiliating international events which might weaken the legitimacy of the senior leaders.
- A conflict with Yemen, or involvement in a conflict with Yemen, if serious and protracted, could threaten the regime. This is currently a remote risk, but in the five to fifteen year period the likelihood of such involvement is very high. The intra-Yememi conflict is heating up, and any unified Yemen will immediately press for return of Asir and Jizan provinces.

Conversely, stable oil prices and any settlement of the Palestinian problem, or any weakening of the linkage of the U.S.-Saudi relationship to the Arab-Israeli conflict, or any resolution of the territorial conflict with the Yemens, would greatly improve the stability of the regime and the prospects for business.