

*January 20, 2015*

## **Saudi Succession**

*(Due to the Martin Luther King Holiday, the next report will be published February 2, 2015.)*

On New Year's Eve, King Abdullah of Saudi Arabia was hospitalized with pneumonia. According to reports, he is taking visitors and will probably survive this illness. On the other hand, the king is at least 90 years old and is becoming increasingly frail.

In light of his advanced age and declining health, an analysis of royal succession in Saudi Arabia is in order. This process is becoming increasingly uncertain. Unlike many European royal families, Saudi successions are not based on primogeniture; instead of passing from the king to his eldest son, it passes to a brother. Due to the advancing age of the second generation of princes, this process is becoming increasingly problematic.

We will begin this report with a history of Saudi kings. Following this history is an examination of the current Saudi succession, focusing on the Crown Prince and who remains as potential kings among the "second generation" of the Saudi Royal Family. In this context, we will analyze the challenges facing the kingdom and how the succession issue will likely complicate the manner in which these issues are resolved. As always, we will conclude with potential market ramifications.

### **History**

Saudi Arabia was founded by Ibn Saud, a charismatic sheik who created the modern kingdom. Through military campaigns and intermarriage, Ibn Saud gradually unified the territory on the Arabian Peninsula to create the modern Saudi state. During this process, he had at least 22 wives and 45 sons, 36 who survived to adulthood. He ruled Saudi Arabia from its founding in 1932 to 1953.

Due the large number of sons, Ibn Saud created a succession plan that would shift from brother to brother rather than from the eldest brother to his eldest son (the aforementioned primogeniture).

The first successor was King Saud, the oldest son of Ibn Saud who survived into adulthood. He was a favorite of the founder. Unfortunately, he proved to be a problematic king. Saud ruled as if the country were his personal fiefdom, instead of a country. His policies were mercurial; sometimes, he would support Arab nationalist movements, only to later support American policy in the region which opposed nationalist programs. His personal habits were extravagant; he took on huge debts that the kingdom struggled to service. Increasingly at odds with his younger brother Faisal, it appeared a civil conflict might develop. However, the family and clergy were able to pressure Saud to abdicate in favor of Faisal in 1964.

Unlike Saud, Faisal, the third son of Ibn Saud, was a cautious, sober man who did not share the extravagant habits of his older

brother. He became King in 1964 after being Saud's prime minister. Known for personal piety and thrifty habits, Faisal put the kingdom's fiscal house in order.

He also introduced public education in the kingdom (for both genders) and ended slavery. His foreign policy was anti-communist and pan-Islamic. Opposing the Arab nationalist movements of Hafez Assad and Gamal Nasser, Faisal wanted to build a pan-Islamic movement that would unify the region based on religion and monarchy. Unlike many of his successors, he preferred a more inclusive position on Islam, embracing both Sunni and Shia. This position actually undermined the influence of clergy in Saudi Arabia, who tended to support a rather strict form of Sunni Islam. During his reign, relations with the U.S. were generally positive due to his opposition to communism. However, Faisal was anti-Zionist and U.S. support for Israel in the 1973 Yom Kippur War led Faisal to order the OPEC oil embargo on the U.S., which led to a quadrupling of oil prices.

Faisal was assassinated by a half-nephew, Faisal bin Musaid, in 1975. It is unclear why Musaid murdered his uncle; Musaid's brother had been killed by Saudi security forces when he attacked a television station Faisal had commissioned. Some sources argue that the assassination was to avenge his brother's death. Musaid did study in the U.S. at the University of Colorado and was arrested in Boulder for possession of LSD and hashish. Some speculate that drug use may have caused insanity. Regardless, he was executed in June 1975 on the charge of regicide.

Khalid, the fourth oldest son (who survived to adulthood) became the fourth king of Saudi Arabia. Interestingly enough, Khalid's older brother, Muhammad,

renounced any claim to the throne, paving the way for his younger brother to become king. Muhammad was a close confidante of both King Khalid and his successor, Fahd, discussed below. However, due to his very conservative views, Muhammad was not considered flexible enough to be king, a flaw he seemed to recognize.

Khalid was seen as a caretaker monarch. He had only a passing interest in politics, although he did ensure that all major decisions required his approval. His disinterest was part of the reason he was popular among the princes. Khalid's reign was characterized by significant economic development. The combination of his predecessor's austerity and the massive revenue infusion that followed the spike in oil prices after the Arab Oil Embargo funded this expansion. He also was less tolerant of religious diversity than Faisal, which boosted the status of the local clerics. Khalid had the unfortunate job of dealing with the 1979 seizure of the Grand Mosque in Mecca. This led to military operations against the militants. It also led Khalid to become even more supportive of religious conservatism.

Khalid suffered from heart disease and had a series of heart attacks and major cardiac surgeries. In 1982, he suffered a fatal heart attack and was succeeded by the prime minister and Crown Prince Fahd.

Fahd was the eighth son of Ibn Saud (seventh oldest son to achieve adulthood). He was also the eldest son of Saud and Hassa al-Sudairi,<sup>1</sup> one of the favorite wives of the founder. Two older sons of Saud, Prince Nasser and Prince Saad, were passed

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<sup>1</sup> Hassa al-Sudairi bore seven sons who survived to adulthood. They are considered perhaps the most influential of Ibn Saud's sons and are nicknamed "the Sudairi Seven."

over when Fahd was crowned as king. Prince Nasser, who was born to a lower ranked wife, was considered unfit due to a scandal that occurred when he was governor of the Riyadh province. Prince Saad was believed to be of weak character and not deemed to have the qualities for leadership.

King Fahd was considered worldly in his personal behavior, known for lavish trips to Europe. He made several significant foreign policy decisions during his reign. Fearing the Iranian Revolution, he actively supported Saddam Hussein's Iraq during the Iran-Iraq War. His oil minister, Zaki Yamani, abandoned the kingdom's OPEC role of swing producer in 1986; this led to a collapse in oil prices and was partly responsible for the downfall of the Soviet Union. Eventually, Fahd, not a fan of the influential Yamani, unceremoniously fired him.<sup>2</sup> King Fahd also invited the U.S. military to Saudi Arabia in the autumn of 1990 after Saddam Hussein invaded and annexed Kuwait. President Bush and Secretary of State Jim Baker built a large coalition to oust Iraq from Kuwait, using Saudi Arabia as a base of operations. Although the execution of the war was impressive, anger at the king for allowing "infidels" to operate in the land of Mecca and Medina spawned al Qaeda, led by Osama bin Laden.

Fahd opposed social reform and spent heavily on military hardware, most likely due to fears caused by the Iran-Iraq War and the First Gulf War. Spending on defense cut expenditures on infrastructure, which weakened economic growth outside the energy sector.

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<sup>2</sup> According to Daniel Yergin, Yamani learned of his sacking by hearing it on television. Yergin, D. (1991). *The Prize: The Epic Quest for Oil, Money, and Power* (p. 763). New York: Simon & Schuster.

In 1992, Fahd tried to create a more formal system of succession, allowing the current king to name his successor instead of relying on informal decisions by the sons of Ibn Saud. The edict allowed the sitting king to select by his own criteria, permitting him to pass over those with seniority and setting the stage for moving to the grandsons of Ibn Saud.

Already in poor health due to smoking, diabetes and obesity, Fahd suffered a major stroke in 1995. Crown Prince Abdullah began to run the kingdom on a regular basis following King Fahd's stroke.

King Abdullah took control of the kingdom after Fahd's death on May 27, 2005. He is the 10<sup>th</sup> son of Ibn Saud; despite the power of the sons of Sudairi, Abdullah became king due to his role as *de facto* regent for 10 years before King Fahd died. Abdullah has been a popular king. In contrast to Fahd, his personal piety and demeanor have improved the standing of the royal family among Saudis. He has promoted some reforms to the Saudi economy, including joining the World Trade Organization, and has made modest moves to ease religious restrictions and support religious diversity. For example, in 2012, he replaced the head of the religious police with a more moderate figure. This isn't to say Abdullah is democratizing the kingdom, but he is attempting to ease internal tensions.

### **Current Issues**

In foreign policy, Saudi Arabia maintains relations with the U.S., although tensions have been rising over the Obama administration's detente with Iran. The kingdom also opposed America's policy to allow Egyptian leader Hosni Mubarak's removal from power. Saudi leaders were concerned about the U.S. ouster of Saddam Hussein, and given the chaos that has

developed in Iraq, these concerns were warranted. Abdullah approved the Saudi military incursion in Bahrain to quell Shia unrest. The Saudi government dramatically increased social spending in light of the “Arab Spring” to quell domestic calls for democracy.

Although Saudi Arabia has opposed Islamic democracy movements, like the Muslim Brotherhood, recently, there is evidence that policy may be changing. In general, Saudi Arabia was uncomfortable with the Islamic parties in Turkey on fears that an Islamic alternative to monarchy would encourage similar movements in the kingdom. However, that posture is coming under scrutiny. If the alternatives to Islamic monarchy are secular dictators, jihadist insurgencies or Shiite theocracy, perhaps the Muslim Brotherhood or similar groups are a better substitute. We will be watching to see if the Saudis try to support such an alternative to the Islamic State in Syria and Iraq.

The other major issue is Saudi Arabia’s decision to let oil prices fall. The situation is somewhat similar to 1986. At this point, we believe Abdullah supports Oil Minister Ali Naimi’s decision to allow prices to fall, but given the king’s health issues and advanced age, royal influence on this policy may be lacking. As we will discuss below, Abdullah does not have an effective regent and so oil policy may be operating somewhat independently of the monarchy. If so, there may be less than a thorough understanding of the geopolitical risks the oil policy may be creating.

### **The Succession Issue**

King Abdullah has outlived two crown princes, Prince Sultan and Prince Nayef. Both deceased crown princes were members of the Sudairi Seven. The current heir

apparent, Crown Prince Salman, also a Sudairi, has serious medical issues. He has suffered a stroke, has had back surgery and is reportedly suffering from Alzheimer’s disease. Although there are 10 remaining princes who, in theory, could be king, most have health, experience or personality issues that all but eliminate them as candidates. Abdullah has probably appointed the last “king eligible” prince, Muqrin, to the post of deputy crown prince. He is the youngest surviving prince of Ibn Saud. This would suggest he is next in line if Salman cannot take office; however, if Abdullah dies and Salman becomes king, it is unclear if Abdullah’s appointment will remain in force or if Salman will appoint his own successor.

Essentially, it is highly likely that within the next decade the third generation of the House of Saud will take power in the kingdom. To facilitate succession to the third generation, King Abdullah created the Allegiance Council in 2006. The council, comprised of senior members of the royal family, in theory, would approve Abdullah’s successor’s crown prince. As we move to the third generation, the council would face the unenviable task of selecting from a large number of princes with a wide dispersion of talents and support within the family. There is no clear line of succession in the third generation. This increases the risks to the oil markets and the region.

### **Ramifications**

The issue of Saudi succession is probably not imminent. Even if King Abdullah does not outlive his third crown prince, it isn’t obvious that his designated successor, Salman, could take power or actually run the kingdom given his health issues. Although there are concerns about the viability of a Muqrin administration, we suspect the royal family will accept him as king simply to

avoid the looming problems that shifting to the next generation will certainly bring.

Deputy Crown Prince Muqrin is young by second generation standards; he will turn 70 in September. As noted above, there are other living sons of Ibn Saud, but none are generally considered strong candidates for king, due to personality, age, experience or health issues. Even Muqrin wasn't considered a strong candidate until he was named deputy crown prince by King Abdullah. Given Muqrin's age and health, his ascension to king would likely give the royal family perhaps a decade before power shifts to the next generation. However, as the above history shows, kings can abdicate, be assassinated or face deteriorating health. It is certain that, at some point, the royal family will need to prepare for a new generation to run the kingdom and create a more set line of succession to avoid the current uncertainty.

For now, the greatest immediate risks to the region and markets from this issue are if (a) Abdullah were to become incapacitated or die, and (b) Crown Prince Salman simply isn't capable of ruling. Since it isn't clear that Prince Muqrin would take power, a succession battle could develop sooner than expected. Given the challenges Saudi Arabia faces, from dwindling American power in the region to a stronger Iran and the breakdown of nation states in the area, a power vacuum in Saudi Arabia would be profoundly dangerous. If conditions deteriorate, it would likely end the current bear market in oil and lead to higher overall inflation in the developed world.

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*This report was prepared by Bill O'Grady of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

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