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Research Global

The US-Saudi deal: a strategic win or a deal with the devil?

- **The war in Gaza initially halted negotiations around a US-Saudi defence pact and the process of SA normalising ties with Israel. But bilateral talks between the US and Saudis have continued behind the scenes, and a deal is said to be near.**
- **Saudi Arabia is the second largest oil producer and the second largest weapons importer in the world. Located in the strategically important Gulf region, it's a desired partner for both the US and China, and a central player in power politics.**
- **The unprecedented deal is likely to entail US security guarantees and support for Saudi civil nuclear program in exchange for limiting investments from China. The deal is unlikely to involve Israel which raises a question: who's the real winner?**

Saudi Arabia, the leading Gulf oil-exporter and a newly joined member of the BRICS+, is the key middle power to watch in the new era. In this note, we explain why Saudi Arabia is such an important player. We also discuss what the deal-in-the-making with the US could entail and what its implications could be for the war in Gaza, as well as its potential consequences for regional security and for the global balance of power.

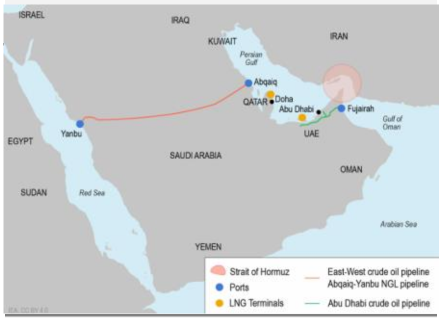
It's the oil, stupid!

Saudi Arabia remains the second largest oil producer in the world after the US. Its share of OPEC oil production is just below 34%, and the majority of OPEC spare production capacity lies in Saudi Arabia. China is nowadays Saudi Arabia's main trading partner, and that is solely thanks to the energy trade. Non-oil exports to China have not grown in recent years, while imports have steadily increased. Trade with the US, on the other hand, is clearly on decline, again mostly due to less hydrocarbons exports.

But even if the US is no longer reliant on Saudi oil, it still cares about the country's role in the global oil market. During his tenure, US President Joe Biden has several times emphasized the importance of gasoline prices to Americans. In the early days of the pandemic, President Biden pleaded to the kingdom to increase production, but the Saudis refused. The recent tensions between Israel and Iran that have raised alarm of a regional war, are a concern for the Americans not only because they undermine peace in the region, but also because they jeopardize the most important route for seaborne energy trade, risking a substantial increase in oil and fuel prices globally.

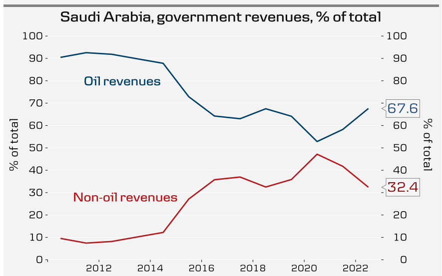
For the Saudis, oil still accounts for close to 70% of government revenues. Most of its oil is being sold to Asia and transported through the Strait of Hormuz, the key logistical chokepoint that *Iran has threatened* to close *'if an enemy came to disrupt them'*. Based on an *IEA estimate*, if all traffic via the Strait would stop, only around 20% of the regional oil exports could be rerouted, meaning that prices would spike. The world economy would face yet another energy shock more severe than the one following Russia's invasion of Ukraine. American voters would face higher gasoline prices potentially during the most heated phase of the US presidential campaigns. Unsurprisingly then, both the US and Saudi Arabia have huge incentives to de-escalate regional tensions.

Strait of Hormuz is a key chokepoint for global energy trade



Source: IEA

Oil revenues still dominate the government revenue base



Source: Saudi Arabian Monetary Agency

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Brothers in arms

Apart from Saudi Arabia's critical role in the global oil market, the kingdom is a loyal customer of the global defence industry. Because of Saudi Arabia's strained relations with Iran, the kingdom has historically invested a lot in military. Saudi Arabia ranks 23rd in the *Global Firepower index* of military strength. It still ranks behind regional peers Turkey (8th), Pakistan (9th), Iran (14th), Egypt (15th) and Israel (17th) but the momentum is there. In the 2000s, Saudi Arabia's annual military expenditure as a share of GDP averaged 9%, more than double the share in the US (3.9%) and significantly higher than that of e.g. Israel (5.8%). Also, over the last 10 years, Saudi Arabia has been the second largest arms importer in the world after India, with the bulk of purchases being from the US (75%), France (7.6%) and Spain (7.0).

However, China is also stepping up its presence. At Saudi Arabia annual arms exhibition in February this year, Chinese state companies for the first time *exhibited under a single brand*. In 2022, the Saudis signed a USD 4 billion deal with China including e.g. armed drones and ballistic missiles. China has also *tailored its offerings* to align with Saudi industrialisation goals. Saudis' locally produced Saqr drone utilises Chinese-designed air-launched missiles. China's arms trade with Saudi Arabia is still small compared to the US but the increased momentum has hardly gone unnoticed in Washington. Nor has the fact that China is also expanding their soft power. In March 2023, *the Chinese facilitated a détente between the arch-rivals Iran and Saudi Arabia*.

Considering China's apparent endeavours to deepen ties with the kingdom, it is not surprising that the Biden administration has been eager to strike a deal with the Saudis despite the setback caused by the Gaza war. After Israel launched its attack on Gaza, it was clear Saudi Arabia could not proceed with a deal that entailed the kingdom normalising its diplomatic ties with Israel in exchange for US security guarantees. Yet, bilateral talks have continued behind the scenes, and now, a *deal is said to be near*.

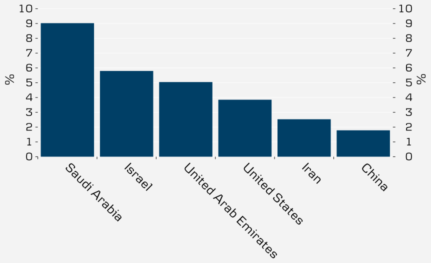
This time, the deal *would entail* a defence pact, US support for a Saudi civil nuclear program, and high-level sharing in the field of AI and other emerging technologies in exchange for Saudi's curtailing of Chinese investments. Israel would be offered to join, and in return of normalising ties with Riyadh, they would have to end the war in Gaza and agree on a path towards a two-state solution. While the bilateral part with the US seems plausible, the latter seems highly unlikely for now. An end to the war is not in sight, let alone Israeli acceptance of the two-state solution. Israeli PM Netanyahu has said their army will enter the city of Rafah regardless of a potential ceasefire deal with Hamas (see *Geopolitical Radar: Gaza truce talks show promise, Xi going to Europe*, 1 May 2024).

A deal without Israel would be a watered-down version, as it would not help regional stability, at least in the short term. Fighting in Gaza would continue to rage while the risk of a regional war would still float in the air. The US would secure a close relationship with its most critical Middle East ally, but the Saudis would most likely still use any leeway they have left to engage with both sides because it is in their interest.

Depending on the scope of the defence pact, the agreement might have to be approved in the US Congress, where many members remain critical towards Saudi Arabia due to its questionable human rights record. A strategic win in the Middle East – even an imperfect one – would help Biden's re-election bid, but without the deal involving Israel, he could have a hard time convincing lawmakers the deal really has anything for the US.

Saudi Arabia's leads regional peers in military expenditure

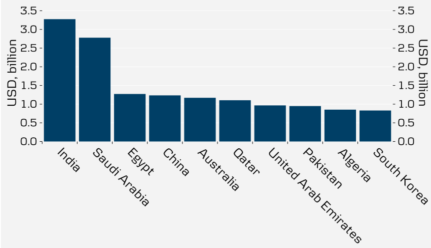
Annual military expenditure, % of GDP, 2000-2022 average



Source: World Bank

Saudi Arabia is the second largest arms importer after India

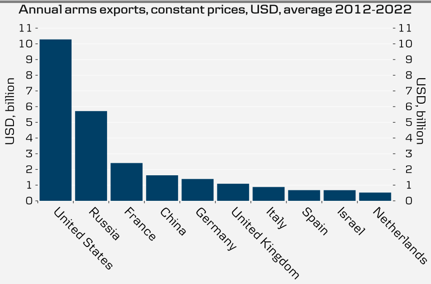
Annual arms imports, constant prices, USD, average 2013-2022



Source: World Bank

The US still dominates global arms exports

Annual arms exports, constant prices, USD, average 2012-2022



Source: World Bank

The King of Coins plays them all?

Saudi Arabia and its authoritarian leadership are perhaps close to a perfect embodiment of what it is to be a winner in the new geopolitical era. "*I don't see our relationship with the US, with China as being mutually exclusive*", Saudi Minister of Investment Khalid Al-Falih told CNBC in June 2023. Unlike during the cold war, middle powers of today have too much leverage so that they could be forced on to anyone's sphere of interest. Whether they end up becoming a balancing force in an era of superpower tensions, or a sway towards an even more unstable and complex world, the jury is still out.

In a pack of tarot cards, the King of Coins depicts a man of considerable earthly power – a diplomatic businessman with a lot of practical wisdom. Read the card reversed, and it represents someone greedy, stubborn and ruthless. If one was to look for a real-life personification of the King of Coins, Saudi Crown Prince Mohammed Bin Salman (MBS) would for sure make a strong candidate. He is undeniably one of the most skilled businessmen and diplomats in the new geopolitical era. His deal-making pursuits are not limited to trade deals, as he has also been active in facilitating peace talks for Ukraine. Yet, his track record for respecting human rights is notorious (not least due to the *Jamal Khashoggi case*). Some American critics of MBS describe him a corrupt psychopath. They are afraid that a deal with the US would allow him to develop a nuclear weapon.

Arming of current allies is never without risks, and nowhere has this lesson been more true than in the complex Middle East. Just keep in mind that until the 1979 Islamic revolution, Iran was one of the closest US allies in the region.

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