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Saudi Arabia's Multiple Crises

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Saudi Arabia faces a series of crises that have put it at the center of international attention. The first is the collapse of international oil prices that has drastically reduced its main source of income. Second, the Joint Comprehensive Plan of Action (JCPOA) nuclear agreement signed between Iran and the P5+1 (China, France, Germany, Russia, the United Kingdom, and the United States) has ended sanctions against Iran, alarming the Saudis because the agreement is perceived as strengthening their main regional rival. The Saudi regime also feels that it has been abandoned by the United States at the expense of Iran and even Russia, which is playing an increasingly important role in the war in Syria.

Third, the rise of the Islamic State has focused attention on the origins of Sunni/Salafi/Wahhabi inspired terror, and Saudi Arabia's financing of mosques and madrasas that are accused of spreading it has come under growing criticism, most notably in Germany. Finally the lack of civil rights in the country has received much wider international attention.

In addition to examining these issues, this issue of Iqtisadi will also review the report on Saudi Arabia issued in December 2015 by the international management consultants, McKinsey & Company, which is believed to be influencing the royal family’s strategy for change.

The economic crisis facing the Saudi kingdom is illustrated in Chart 1. This shows how oil revenues grew rapidly until 2013 and how dramatically they have fallen since then. The population has risen by 50 percent since 2000, resulting in an increased need for funds.

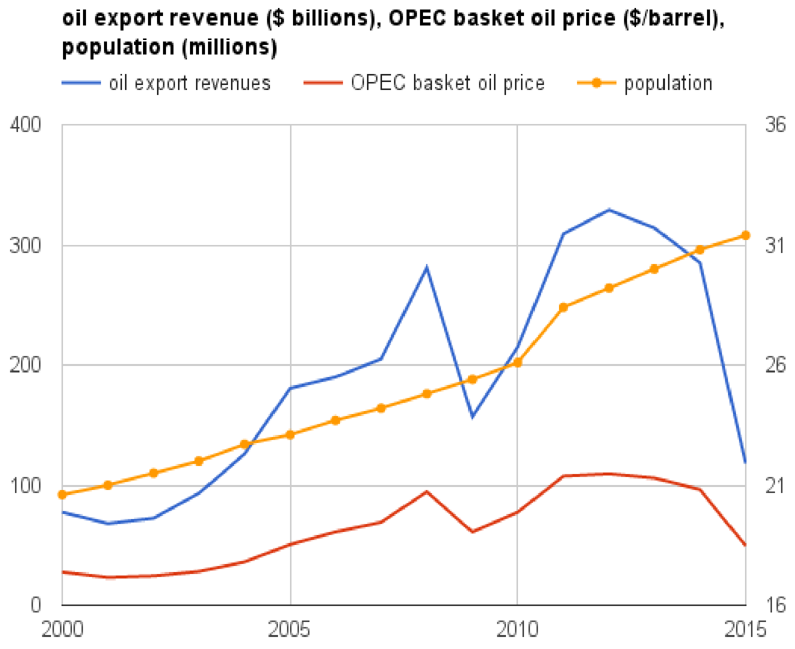
Assuming that in 2016 Saudi Arabia continues to produce 10 million barrels of oil a day (mb/d), and exports 7.1 mb/d, as in 2015, then oil export revenues will be $130 billion, if the price averages $50/barrel during the year. If the price averages $25/barrel oil revenues will be only $65 billion. At the end of January 2016**,** the OPEC basket price for a barrel of oil was $29. In 2015 oil export revenues were an estimated $118 billion, compared with their 2012 peak of $329 billion.

Between 2007 and 2014 the share of oil as a percentage of total government revenues averaged 89 percent, while the share of oil as a percentage of total exports averaged 86 percent. This huge reliance on oil is now a major source of anxiety and is one of the reasons why King Salman bin ʿAbd al-ʿAziz Al Saʿud, and his son, Mohammad bin Salman Al Saʿud, the deputy crown prince of Saudi Arabia, second deputy prime minister, and minister of defense, are contemplating radical changes including the sale of shares in Saudi Aramco, the national oil company.

The pressures facing the Saudi kingdom are summarized in Chart 1. It shows the fluctuations in oil revenues, largely resulting from changing oil prices against a background of a growing population. Each time oil revenues fall, the pressure on the government is greater because the population is larger.

Chart 1

Saudi Arabia, 2000-2010



The International Monetary Fund (IMF) forecasts slower growth in Saudi Arabia: In 2016 it expects the Saudi economy to grow by 1.2 percent and in 2017 by 1.9 percent. This compares with growth of 3.6 percent in 2014 and an estimated 3.4 percent growth in 2015.

Table 1 shows how the current account of the balance of payments and the state budget have gone into deficit. The most recent state budget has been funded by domestic borrowing. The current account and public sector deficits in Saudi Arabia and other Gulf oil producers may well have been one of the factors behind the decline in international oil prices. The Saudi Arabian Monetary Authority (SAMA) reserves fell by 16 percent in 2015, and the reserves invested in foreign securities fell by 26 percent.

Table 1

The central government budget and current account of the balance of payments, 2010-2015 (as a percentage of GDP)

	2010	2011	2012	2013	2014	2015 projected
Central government revenue	37.5	44.5	45.3	41.4	37.3	29.9
Central government expenditure	34.0	33.4	33.3	35.6	40.8	49.5
Fiscal balance	3.5	11.1	12.0	5.8	-3.5	-19.6
Current account $ billions	66.8	158.6	164.8	135.5	81.2	-5.8
Current account (% of GDP)	12.7	23.7	22.4	18.2	10.9	-0.9

Source: International Monetary Fund (IMF)

Economic growth has been based on oil export revenues that accrue to the state. The government allocated these revenues to individuals and companies through spending in the budget. Oil export revenues are threatened, not only by low oil prices, but also by the rapid increase in domestic energy use. This has been encouraged by subsidies that have made gas for automobiles and electricity for all consumers very cheap. The growth of domestic energy demand has been forecasted to threaten Saudi oil exports because oil is used to generate electricity.

In a report entitled "Saudi Arabia Beyond Oil: the Investment and Productivity Transformation," issued in December 2015, the McKinsey Global Institute made the following points: In 2003, Saudi Arabia was the world's twenty-seventh largest economy and the 2003 to 2013 oil price boom made it the world's nineteenth largest, with a national income of $750 billion, larger than that of Switzerland and Sweden. Saudi GDP per capita ranks between that of Portugal and South Korea. The national debt had been eliminated and foreign reserves of over $700 billion accumulated, which were similar in size to the GDP. These figures should, however, be used with caution because one third of the population is made up of foreign workers and oil plays such a large role in the economy, accounting for some 90 percent of government revenues.

According to McKinsey, the oil-financed model of development no longer works. Although Saudi Arabia is producing record amounts of oil, the revenues that it is earning have fallen sharply. (See the November 2015 edition of *Iqtisadi*: "The Saudi Predicament: Low Oil Prices and Strategic Threats"). By 2030 another 4.7 million people will enter the labor market, assuming that the very low female participation rate does not change. If increasing numbers of women join the work force, then the increase in the number of people looking for work will be larger. Saudi Arabia therefore needs to produce three times as many jobs for Saudi citizens (and not for foreign workers) than it did in 2003 to 2013. Furthermore, there will be more elderly people needing support than in the past.

Despite an increase in fuel prices, announced in 2015, Saudi Arabia, like many other countries in the Middle East, subsidizes energy prices. This encourages consumption and potentially reduces the amount of oil available for export. The future of Saudi oil exports will therefore depend not only on an oversupplied international market but also on its domestic energy policy.

McKinsey made a series of recommendations designed to insure Saudi Arabia's economic future. The most important of these is a move from a state-dominated economy to one based on market forces. This will involve reducing public spending, raising taxes, and shrinking the public sector. There is a lot of evidence that the new leadership in Saudi Arabia is contemplating radical changes, including selling shares in the national oil company, Aramco.

In an interview with the *Economist* published in January 2016, Deputy Crown Prince Mohammad bin Salman discussed his interest in selling parts of Aramco to private investors. This potentially represents a radical change from the style of rule of a previous generation of Saudi princes who governed for more than 70 years. Using private sector advisers, Mohammad bin Salman spoke about introducing new taxes, privatizing health and education services, and trimming the public payroll — all of which are backed by the McKinsey report and others.

Aramco is responsible for more than 70 percent of government's revenue. It has enjoyed a special, protected status since it was bought from its American owners in the 1970s. The result has been what many call a state within a state. The company has its own residential cities, hospitals, and schools. It also has a reputation for efficiency among Saudi institutions and is an attractive employer for young Saudis.

In 2007, Saudi Aramco began to build a world-class graduate research university, the King ʿAbdullah University of Science and Technology (KAUST), on the Red Sea coast. King ʿAbdullah bin ʿAbd al-ʿAziz Al Saʿud chose Aramco to build the university in order to avoid the government and religious establishments: he wanted the university to be created quickly and he wanted men and women to be able to work and study there together.

Despite its progressive management style, Aramco publishes very little information about its operations or finances and has managed to keep the government at bay. The implications of privatization or even partial privatization may be radical if they require the release of more information.

At the end of 2015, the Minister of Finance Ibrahim al-Assaf was quoted as saying that Saudi Arabia will gradually apply a value-added tax of 5 percent at the beginning of 2016. At its last session in 2015, chaired by King Salman bin ʿAbd al-ʿAziz Al Saʿud, the Cabinet announced new fees on numerous services and the lifting of subsidies on a number of goods, notably petroleum derivatives. The price of 95 octane gasoline at 0.90 riyals per liter, was increased from 0.60 riyals per liter ($0. 91 per US gallon, up from $0.60) and the price of 91 octane gasoline was raised from 0.45 riyals per liter to 0.75 riyals per liter.

The problems facing Saudi Arabia are not, however, just economic. As Saudi Arabia's economy is perceived to be weaker, largely because of the effects of falling oil prices, so its immunity from criticism is ending. In December 2015, the German vice-chancellor, Sigmar Gabriel, publicly accused Saudi Arabia of financing Islamic extremism in the West and warned that it must stop. He said that the Saudi regime was funding extremist mosques and communities that pose a danger to public security. He was quoted as saying that Germany has to make it clear to the Saudis that ignoring the issue is no longer possible. Wahhabi mosques all over the world are financed by Saudi Arabia and many Islamists who are a threat to public safety come from those communities in Germany. German intelligence has also warned that Saudi Arabia is at risk of becoming a major destabilizing influence in the Arab world.

In January 2016, the leader of the UK Liberal Democrat party, Tim Farron, called for a parliamentary debate on the UK's relationship with Saudi Arabia following the execution of 47 prisoners in a single day. The United States also warned that the execution of prominent Shiʿi cleric Sheikh Nimr al-Nimr and others will worsen sectarian tensions.

Along with a deteriorating international image, Saudi Arabia faces major regional challenges. It views Iran as a serious threat, and the ending of sanctions against Iran, following the nuclear agreement, has strengthened this feeling because it benefits Iran politically and economically. Saudi Arabia is now fighting wars, or proxy wars, against Iran in Yemen and Syria. In Syria, Russian intervention in favor of the Asad regime, coincides with Iranian interests and threatens those of Saudi Arabia. Saudi interventions in Yemen and Syria, along with its support for Egypt, are also a strain on the budget. This combination of internal and external pressures is moving Saudi Arabia into a new era that has yet to be defined.