The Saudi Arabian 'boomerang'

For decades the Saudis have used oil to keep things ticking over in the Middle East. Things are changing and Riyadh's room for manoeuvre is shrinking

by Marco Fosci *



Since the second half of 2014, Saudi Arabia has gradually increased its oil production and caused a steady drop in the price of Brent crude oil from $110 a barrel (€99) to close to just $30 (€27), the lowest price recorded in the last 13 years.

For many months, economists assumed that the monarchy was striving to protect its market share against non-OPEC (the Organisation of Petroleum Exporting Companies) production and particularly American shale oil.

But those with a deeper understanding of the Middle East know that Saudi decisions are never based on economic considerations alone. The kingdom's actions are influenced by events in the Arab world, especially the precarious relations between Sunnis and Shiites, and the Saudi tendency to seek control over Arab Gulf countries.

Seen in this light, the move is also an attempt to weaken rival powers that have tried to meddle in the crises in Syria, Iraq, Yemen and Bahrain. The rival powers here are clearly Iran and its main ally, Russia.

Saudi Arabia comes a close second to Venezuela in terms of proven oil reserves, but it enjoys much lower extraction costs and has a production capacity of over one-tenth of the total world supply. The state-owned oil company Aramco is a colossus, with an estimated value of over 2trillion dollars (€1.8tn), almost four times that of Apple. The fact that Riyadh can influence oil prices has been well known since the Arab-Israeli Yom Kippur war in 1973. At the time, OPEC, led by the Saudis, engaged in an oil embargo against Western countries. Over the course of a few months, crude oil prices rose fourfold, leading to a major international economic crisis.

A recent investigation by the American historian Andrew Scott Cooper, based on declassified documents produced during the Nixon administration, shows how the Saudi's leverage over oil was also used to destabilize Iran prior to the Islamic Revolution in 1979.

At the time, Shah Reza Pahlavi's arms escalation was viewed by Riyadh as a threat to the balance of power in the Middle East. The Saudis flooded the market with crude oil, leading to a drop in prices and lower revenues for Iran, thus helping to turn the country's already complex internal situation into a crisis.

After the revolution and the birth of Ayatollah Khomeini's Islamic Republic, the Saudis took the Iranian's place as the United States' main ally in the region, thus effectively becoming the guarantors of the stability of oil markets. In exchange, they asked for and obtained military protection.

Under the influence of Washington, the threat posed by the Soviet invasion of Afghanistan in the years that followed led Riyadh to play a major role in bringing about the end of the Cold War.

"The time line of the collapse of the Soviet Union can be traced back to 13 September 1985", wrote the Russian economist and former Prime Minister of the Russian Federation Egor Timurovič Gajdar shortly before his death. "On that date, Sheikh Ahmed Zaki Yamani, Saudi Arabia's petroleum minister, declared that the monarchy had opted for a radical change in its oil policies".

In six months, Saudi production increased fourfold and oil prices crashed. "As a result", according to Gadjar, "the Soviet Union lost around $20 billion a year, money without which the country could simply not survive".

Today, the playing field in the Middle East has changed once again. The United States' nuclear agreement with Iran and the ensuing end to the embargo have brought Tehran's oil reserves back onto the international market. The energy independence achieved through shale oil has



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enabled the United States to wind down its commitments in the region even in the face of the instability in Syria and Iraq.

On the other hand, the Saudis are no longer as militarily helpless as they once were. According to a 2015 study by the Stockholm International Peace Research Institute (SIPRI), Riyadh spends $87.2 billion (€78.7bn) on military expenditures annually. Ranked third worldwide, Saudi Arabia is topped only by the US and China, and far outspends Russia and the UK.

It should be noted that the Saudis spend 13.7% of their GDP on arms (compared to 5.4% in Russia, 3.5% in the US, 2% in the UK and 1.9% in China). But thanks to their increased military might, the Saudis have begun exerting direct pressure on nearby countries, as witnessed in Bahrain in 2011 and in Syria and Yemen in 2015.

Nevertheless, these military operations reveal the limitations of the political approach developed after the coronation of the 80-year-old King Salman and the rise of his young son, Mohammad bin Salman, now chief of the Royal Court and second in line to the throne.

As minister of defence, Prince Mohammad began deploying large numbers of Saudi troops in a military campaign intended to quickly restore peace and order in Yemen, a country torn apart by civil war. A year and half later, the political situation in Yemen remains very much unresolved. The country has been devastated and finds itself in the throes of a humanitarian ▸▸

NON OIL ECONOMY

Saudi Arabia's Vision 2030, issued by Mohammed bin Salman, is an economic diversification plan aimed at minimizing the kingdom's dependence on oil. Over the next 14 years, the Saudis intend to create the largest sovereign fund in the world, which will hold state assets (including Aramco and real estate) and preside over a budget of around €1.78 billion.

The plan is based on three pillars and, if successful, would raise Saudi Arabia's share of non-oil exports from 16% to 50% of GDP.

The first pillar is the kingdom's status as the heart of the Arabic and Islamic worlds: the Saudis recognize that almighty Allah has bestowed a gift on their lands more precious than oil.

The second pillar is the determination to become a global investment powerhouse: the country of Saudi Arabia has strong investment capabilities, which it will harness to stimulate its economy and diversify revenues.

The third pillar utilizes the unique strategic location of the country in order to transform it into a global hub that connects three continents: Asia, Europe and Africa.

In order to build the institutional capacity and strength necessary to achieve the ambitious goals of Vision 2030, the National Transformation Program 2020 has been launched, affecting 24 government bodies in the economic and development sectors in its first year. It is notable that the programme's strategic objectives are linked to interim targets for the year 2020: job creation for women and young people, a greater openness to foreign investment, the improvement of public services, the rationalization of expenditure, the promotion of small- and medium-sized enterprises and privatization. Vision 2030 also focuses on priority areas such as renewable energy, industry, tourism, mining, defence and the creation of a national network for gas distribution.



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Above. **New Saudi Energy Minister Khalid al-Falih. Previous to this appointment, Falih was president of the national oil company Aramco and health minister.**
Previous page. **The OPEC summit held in Vienna in June.**

catastrophe. Numerous Saudi bombings against the Houthi rebels have hit markets, hospitals, factories and private homes. The UN High Commissioner for Human Rights, Zeid Ra'ad Al Hussein, has reported that a large portion of the over 3,200 civilian deaths were a result of the bombings. If serious mistakes in the field are indications of inefficiency, often bordering on incompetence, the overall assessment of the conflict is no more flattering. In November 2015, the Washington Post was already describing Yemen as a quagmire, a Saudi Vietnam, an assessment shared by many other political commentators.

The most worrying development for Riyadh, however, lies elsewhere. In April, the International Monetary Fund (IMF) revealed that since King Salman's ascent to the throne, the imposing Saudi monetary reserves have dropped from $734 billion (€663bn) to $580 billion (€523bn).

For an economy bound in no uncertain terms to oil sales, wiping out $154 billion dollars (€139bn) in six months could spell danger. This is particularly the case as the IMF, in its macroeconomic forecasts for 2016, stated that for the kingdom to balance its books, it would need crude oil prices to stay at $66.7 (€60.2) per barrel.

That same month, Prince Mohammad admitted that his country was "hooked on oil" and announced a large-scale national transformation program: Vision 2030.

With this program, the monarchy intends to impose radical change on the country, freeing its economy from the shackles of black gold in little more than a decade, clearing space for private initiatives and for women to work, and selling off a small share of Aramco in order to set up the largest sovereign wealth fund on the planet.

By the year 2020, the program is expected to have created 450,000 jobs in private enterprise, tripled the Saudi's non-oil revenue and reduced public salaries (perhaps overlooking the fact that one-third of the Saudi workforce is employed by the state).

It is an ambitious plan, very much at odds with the general mood of one of the most conservative societies in the world, where employment for women meets fierce opposition from the Wahhabi clergy and unrest has been on the rise following cuts to water and energy subsidies.

Halfway through 2016, the price of a barrel of oil has climbed back up to $50 owing to the problems of a few major producers (Nigeria, Libya and Canada). Riyadh is reaping the benefits of higher oil prices, but the battle over quotas with Iran is ongoing, and the Saudis are still pumping as much oil from their fields as they can.

Today, Saudi Arabia's oil reign appears to have lost momentum. High oil prices boost its rival powers; low prices eat away at its ability to support the state. The monarchy is driving down a blind alley while relying on an economic program to change things around that is based more on wishful thinking than tangible and achievable objectives. e

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