Sustainable growth and the stability of oil prices – the Kingdom of Saudi Arabia’s objectives

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The Kingdom of Saudi Arabia’s importance within the Group of Twenty (G20) lies in its being the world’s largest oil producer and exporter, and the only OPEC member in the group. This gives it a rather special position. Additionally, Saudi Arabia is the largest economy in the Middle East and the only state from this vital region that is a member of the G20. Besides which, the Kingdom holds the position of the leading state in the Arab and Islamic world.

Unlike many other G20 members, it is only recently, as a result of accumulated revenues from its significant oil exports, that international financial markets have become relevant for Saudi Arabia. High oil prices have added considerably to the Kingdom’s revenues, so much so that during the past few years the Kingdom has smoothly transitioned from being a net debtor to a creditor state. At the same time, the effects of globalisation have brought the realisation that the Kingdom cannot be aloof from, or remain unaffected by, economic and political developments in other parts of the world. These developments outside the Kingdom’s borders have an impact on the country’s policies, but are beyond its control. In the interconnected world of today, the country’s financial system is inevitably linked to the global financial markets and, therefore, is exposed to global market forces. For these reasons, the Kingdom’s membership in the G20 was seen as important in securing stability for the Saudi economy and contributing to the stability and development of the world economy.

In recent years, Saudi Arabia has been one of the best performing economies in the G20. According to an International Monetary Fund (IMF) report, the Kingdom, in the year 2012, topped the ranking in terms of economic performance among the leading G20 nations and has played a stabilising role in the global oil market. The IMF said the Saudi economy grew by 5.1 per cent in 2012, benefitting from high oil prices and output, which had led to large fiscal and current account surpluses and rising international reserves. However, according to current forecasts, in 2013 the Kingdom’s growth could slow to 4 per cent.

At the same time, the Saudi economy has grown beyond oil and is expanding and diversifying at a rapid rate. As part of its efforts to incorporate G20 commitments, the
Kingdom has embarked on reform of its financial and banking system, promoting financial regulations that reduce risks and could help to prevent future financial crises, and modernising national financial architecture. The Global Competitiveness Index of the World Economic Forum (WEF) now ranks Saudi Arabia as the 20th most competitive economy in the world.²

**The Kingdom’s leadership places emphasis on a ‘reasonable oil price’**

The Kingdom’s leadership is fully conscious of the responsibilities inherent in being a superpower in the world oil market. They understand the direct impact of high and volatile oil prices on world economic growth. The high price of oil is not, of course, the only issue troubling the world economy and hindering growth, but it constitutes one of the primary factors that contribute to instability in the world economy. Thus, as a member of the G20, facilitating healthy growth of the world economy constitutes the cornerstone of Saudi Arabia’s oil policy.

It has become a customary practice for Saudi policy-makers to indicate from time to time the mark or a specific range for what they consider ‘a reasonable or fair price’ for a barrel of crude oil. The Saudi practice is not unusual, as oil prices have long been manipulated for specific policy objectives. Price is a function of supply and demand. The responsibility of Saudi Arabia, the world’s pre-eminent oil power and swing producer, is to maintain the supply–demand balance. The role of swing producer has given the Kingdom considerable influence in the oil market. In fact, oil price stability and the maintenance of reasonable prices lie at the heart of Saudi Arabia’s oil policy. The Kingdom’s leadership recognises that rising crude prices could derail global economic recovery and lead the way to steep decline, and that short-run gain from high oil prices may be offset by reduced sales in the future.

Saudi Arabia produced 13.3 per cent of global oil in 2012, and at present has an average production capacity of 10 million barrels per day. With its presumed 2 million plus barrels per day of spare capacity (out of a presumed 6 million barrels per day of OPEC total spare capacity), it is determined to retain its role as the world’s swing producer and the political and market influence that this confers.

Over the last two and a half decades, oil prices have fluctuated considerably. These fluctuations have been more pronounced than at any other time in history and consequently the definition of reasonable or fair prices has also varied. In March 2013, Saudi Oil Minister Ali Al-Naimi assured the world that his country’s concern is about maintaining global economic growth, not about maintaining oil prices at any specific level, and promised that
Saudi Arabia will work hard to maintain ‘reasonable’ oil prices. But he also clearly expressed his thoughts regarding the limitation associated with such terminology as ‘reasonable or fair prices’, saying:

My first speech in Asia as minister was in Singapore in 1996. Oil was just over $20 a barrel and I told the audience that the price, at the time, seemed reasonable. Four years later, the price was about $27, and was still seen as reasonable. Today, it’s up around $100 and it seems reasonable.3

The Kingdom’s leadership also showed some concern about the effect of high oil prices on future oil consumption and the possibility that high oil prices could lead to ‘demand destruction’. This could, in turn, result in a permanent shift on the demand curve in the direction of lower demand, leaving the major oil-producing countries, especially Saudi Arabia, with considerable ‘idle excess capacity’. Extremely low oil prices, on the other hand, affect the growth potential of the producing countries and the flow of investment to the industry, which would ultimately undermine oil supply security, with detrimental impact on the interests of both producing and consuming countries. Several officials of the Kingdom have argued that $100 a barrel would be a ‘fair’ price for crude. Indeed, Saudi price targets, which lie in a band around $100 per barrel, are not out of line with the interests of many industrial countries.

The impact of rising oil prices on food prices is well-documented. Saudi Arabia is gradually moving towards becoming a net food importer. Given the unsustainable exploitation of the scarce water resources of the Kingdom, the Saudi government recently decided to phase out local food production.4 By 2020, food imports are expected to increase by 35 per cent, according to a report issued by the Foodex Saudi Expo.5 In recent years, Saudi Arabia has made various attempts to invest in food production abroad and has launched the King Abdullah Initiative for Saudi Agriculture Investment Abroad, with an investment fund of 3 billion Saudi riyals. Thirty-five countries have been targeted for agro-investments,6 but this is an exercise fraught with political sensitivity and the Kingdom has been accused of embarking on a ‘neocolonial investment strategy’ targeting the poor and developing countries. Volatility of oil and food commodity markets does not serve the Kingdom’s national interests.

How oil prices might be managed in the long run is subject to several challenges and to the impact of speculative forces that lie outside the reach of the Kingdom’s influence, and even outside the global oil markets. Thus, the G20 could be the right venue to assist the Kingdom
in influencing medium- and long-term oil price expectations and in helping make these markets less volatile.

Notes

1. Senior Advisor and Director of the Security and Defence Studies Department at the Gulf Research Center (GRC), Kingdom of Saudi Arabia