Is Saudi Arabia Heading Toward Economic Crisis?

A two-year nosedive of the global oil prices has taken a toll on the majority of commodity-dependent countries pushing them into a deep recession. For the record, as the US had ended its quantitative easing program and started stepping up the production of shale oil, and as the outlook for the emerging markets had been reassessed, the commodity prices fell almost two-fold. Quite naturally, economies with heavy dependence on the revenues from the sales of the “black gold” sustained the hardest blow. Take, for example, Saudi Arabia, whose budget deficit reached an unprecedented level of 15% of GDP last year, i.e., the highest number in the 30-year period since 1987.

In other words, an adverse situation on the world commodity market had spurred a whole range of socio-economic problems in the Kingdom. Economists note that this largest Arab economy is going through one of the most trying and difficult periods in its modern history. What is most depressing, the “bottom” of the economic hardships being accompanied by extremely volatile political situation in the Middle East, has not been reached yet. The complex problems Saudis face continue snowballing threatening to transform into a catastrophe. Despite sporadic efforts of the Saudi government and fiscal consolidation, it is estimated that budget deficit will reach 10-12% of GDP in 2016. To keep the deficit under control, the government would have to either dramatically reduce expenditures, primarily by cutting jobs, or pray for the oil revenues to increase.

What is noteworthy, when cutting jobs, Saudis let go mostly of foreign workers (according to various estimates, there are anywhere from 8 to 10 million of them working in the country). Unscrupulous companies were quick to jump at the opportunity and refused to pay the laid-off employees their wages prompting unrest among foreign workers. The situation was so critical that the Saudi government had to pay about $1 billion to the largest construction company in an attempt to restrain the impending unrest compounded by the perpetually falling oil prices. According to The Wall Street Journal, the Saudi company Saudi Binladin Group engaged in such projects as reconstruction of Al-Masjid al-Haram (The Holy Mosque) in Mecca and of a financial district in Riyadh has received about $1.1 billion from the government to pay the overdue wages. The sums paid by the government (the exact amount remains undisclosed) were used to remunerate tens of thousands of migrant workers so that they could pay their way back home.

Saudi Press Agency reported that another large construction company Saudi Oger, owned by Lebanese, was poised on the brink of bankruptcy because it had failed to pay wages to thousands of workers and laid-off employees. Among the victims of the situation are other countries whose citizens were working in Saudi Arabia. Similar situation affecting numerous contractors and small businesses is observed in other sectors of the economy as well.

At the same time, living conditions of migrants working in the country have deteriorated so badly that some migrants suffer from shortages of food. To support its citizens, who had been hired and later laid off by Saudi Oger and are now unable to pay for the tickets to get back home, the Indian government had to send food staff to Saudi Arabia.

In an effort to pursue its retrenchment policy, the Saudi government announced a forthcoming reduction of salaries of the country’s senior government officials and allowances and benefits paid to public employees. King Salman bin Abdulaziz Al Saud demanded that the salaries of the ministers be cut by 20% and bonuses paid to all members of Shura Council, the supreme advisory body of the country, be also reduced, reported Saudi Arabia’s state news agency. The country’s ministries are also revising construction projects worth tens of billions of dollars. According to
the data quoted by analysts of the National Commercial Bank, costs of new building contacts in the Kingdom dropped by 59% in the first half of 2016 to compare to the same period of 2015, which is explained with shrinking public investment in the development of the country's infrastructure.

As experts note, the current situation challenges an unwritten "social contract" between the Saudi ruling elite and the country's ordinary citizens. According to its "provisions," the country's middle- and lower-level officials are guaranteed life-long undemanding employment in exchange for absolute loyalty to the government and support of its policy. It should be stressed that in Saudi Arabia majority of citizens are employed by the public sector, and two-thirds of jobs are associated with public services at least to some extent. Therefore, about 45% ($128 billion in 2015) of federal funds are allocated for the payment of salaries or employee benefits.

Undoubtedly, current devaluation of the "black gold" lies at the heart of all socio-economic problems experienced by the global leader in oil production and exports. Until recently, the Saudi authorities were captivated by the idea (and persuaded their external partners of its relevance) that it was much more important to maintain their share of the oil market than to take steps to boost oil prices. However, as the internal problems continued piling up, the country could no longer rely on its war chest of reserves accumulated during the "fat" years and began a frenetic search for a way out from the emerging large-scale crisis.

Today, in defiance of all expectations, Saudi Arabia is trying to turn the clock back by stimulating the growth of oil prices. Riyadh and its OPEC partners are now saying that the rate of oil extraction should be suppressed for the oil price to be satisfactory for all producers. As for the meeting of OPEC held in Algeria during the International Energy Forum (September 26−28), it has just somewhat smoothed things down but has not eradicated all the contradictions haunting the oil cartel.

Admittedly, it is highly unlikely for the situation to improve any time soon. According to specialists, since the Saudi economy has not been able to break free from dependence on oil, the situation will continue deteriorating. If the cost of oil continues fluctuating around $45-50 per barrel, the Saudis' gold and forex reserves could melt much faster than expected. Meanwhile, Saudi Arabia maintains oil production at record level of 10.67 million barrels per day. However, though the country has managed to retain its market share, it continues contributing to the oversaturation of the market. Apparently, with such state of affairs, there is little hope that oil price will improve in the short-term perspective. As for the Saudi rulers who have thoughtlessly initiated the reduction of prices, they have found themselves between the rock and the hard place.

The internal problems caused by incompetence of the Saudi rulers are now being compounded by the exacerbating instability along the entire country's border being the result of Riyadh's ill-considered foreign policy. The unleashed for no apparent reasons war in Yemen that seemed to have settled, has been resumed and is heating up. The risk of destabilization of the internal situation in the neighboring Arab countries, for example, in Bahrain, pours oil on Saudi's flames. The situation in Syria with direct involvement of the US and Russia is close to going up to another rung on the military escalation ladder. Since Saudi Arabian rulers were reluctant to deal with the terrorism issues, the country, and especially its Eastern province, is at a great risk of random turmoil. The situation in Saudi Arabia should be analyzed in the context of intensifying activities in the region and across the entire Middle East, especially since Iran, which is no longer under sanctions, is looking to regain its political and economic positions.

Today the future of Saudi Arabia depends on the ability of its King and his government to solve complex problems faced by the country in a wise and prompt manner.

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