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Saudi Economics and Saudi Stability:

The Facts Behind the Speculation

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The death of King Fahd and the succession of Crown Prince Abdullah have unleashed a flood of articles on Saudi stability, the Royal Family, Saudi security, and Saudi economics. Many of the latter articles have been badly out of date, and many make assertions that are simply wrong. It may be useful to point out a few facts.

The Structural Pressures for Saudi Economic Reform

Saudi Arabia does need economic reform. This is a point that King Abdullah has been stressing for years, and this need for reform is driven in large part by demographics. There is no reliable way to estimate Saudi population growth, but the latest UN report on World Population Prospects (2004) estimates that Saudi Arabia grew from a nation with only 3.5 million in 1950 to one with 24.6 million in 2005.

Even if a major reduction takes place in the Saudi fertility rate, the UN estimates that the population of Saudi Arabia will grow to 30.8 million in 2015, 37.2 million in 2025, and 49.5 million in 2050. Saudi census figures do produce a slightly lower rate of past growth than the UN, but the difference is meaningless in terms of the dynamics of future population growth. Furthermore, Saudi Arabia and most Arab states have not yet experienced the early stages of the kind of decline in fertility rates the UN estimates -- which is based more on Asian than Middle Eastern experience.

This issue is critical because the UN estimates indicate that Saudi population growth will decline from an average annual growth rate of 2.8% during 1995-2005, to 2.69% in 2000-2005, 2.17% during 2006-2010, 1.76% during 2020-2025, and 0.83% in 2045-2050.

Among other things, this rate of decline tacitly assumes a major increase in the role of women in the work force and a major change in Saudi family values to permit far more population planning. If these changes do not occur, Saudi population growth could be far higher.

Even if the UN figures prove to be right, it is difficult to postulate any scenario where Saudi Arabia will not see a serious decline in per capita oil export earnings even if it does achieve the UN's estimated decline in population growth.

Moreover, Saudi Arabia has a very young population. Some 37.3% of its population is in the 0-14 years of age group, which compares to 20.8% for the US, 17.9% for the UK, and 14.3% for Spain. The UN estimates this figure will drop from 37.3% to 19.9% by 2050, but Saudi Arabia faces at least two decades of sharply increasing demand for jobs before this decline will affect new entrants to the labor force.

The CIA (World Factbook 2005) estimates that the median age of Saudis is now only 21.3 years of age, and that some 247,000 Saudi males now reach the age where they should enter the labor force each year. If women and men were fully employed, the total number of potential job entrants would each 500,000 a year. This is a massive increase in a country where the labor force is now estimated to be 6.62 million, of which less than 4.3 million is estimated to be native Saudi.

The scale of these pressures is hidden in a great deal of reporting on Saudi Arabia by estimates that restrict the work force using definitions that sharply reduce the number of Saudis said to be seeking work. As a result, sources like the SAMBA Financial Group report male unemployment as being only 8.8% for 2005--a rate that has climbed from 6.7% in 1999 in spite of a massive increase in oil export earnings. The CIA, however, estimates an unemployment rate of 25%--which seems to include disguised unemployment as well as direct unemployment. This 25% rate is also based only on males, and reporting the total disguises the fact it is very heavily concentrated among younger males.

No one who looks at these figures can ignore the problems they raise for stability. They are also compounded by a number of factors that almost all analysts agree upon:

- The low rate of job creation in the petroleum sector.
- Gross over-employment in the government sector, much of it in hollow jobs.
- The creation of extended family jobs in the service sector--jobs created by friends and relatives.
- Gross over-dependence on foreign labor caused by past underpricing state services for that labor and overvaluing and protecting Saudi labor.
- A slow rate of reform in opening up and encouraging the private sector.
- Underfunding of infrastructure growth, including electricity, water, and sewers, during the years of budget deficits in the 1990s.
- A similar underfunding of education and medical services during that period.
- A past failure to create a Saudi work ethic, coupled to education by rote learning that fails to prepare young Saudis for the work force.

The Role of King Abdullah and Saudi Reform

All that said, anyone familiar with the role Crown Prince Abdullah has played since the mid-1990s, is also familiar with the fact that he has raised everyone of these issues and has stressed the need for economic diversification, Saudisation of the work force, expanding the private sector, more foreign investment, etc. He has also been a leader in opposing favoritism and corruption, and has sharply cut back on the government payments to members of the royal family and other traditional recipients of government largesse.

Any one who bothers to read the Saudi Five Year Plan, Saudi budget, and reporting of the Saudi Monetary Agency is also aware that real money is going into structural economic reform, to job creation, and to correcting the past underfunding of infrastructure, education, and medical services. (See SAMA's annual reports: <http://www.sama.gov.sa/>; Current Saudi Five Year Plan: <http://www.planning.gov.sa/PLANNING/INTROe.HTM>)

These points are critical because so much of the Western analysis of the Kingdom focuses solely on political reform and ignore what the Kingdom has done and is trying to do in economic reform. Economic reform is at least as important, and probably has far more real-world priority for most Saudis. These are areas where Saudi Arabia has already taken important steps. In fact, Saudi Arabia has one of the most aggressive economic reform efforts of any country in the Middle East. It is certainly imperfect and slow moving, but it is also very real.

Near-Term Economic Issues

It is also important to note that Saudi Arabia's mid and longer-term economic challenge as one thing, and its short-term economics are quite another. Saudi disguised unemployment may not be efficient, but it does create jobs and income flow for many young men. Many Saudi families also have substantial capital holdings inside and outside Saudi Arabia. There are no reliable estimates of such holdings, but past US Treasury studies put them well above several hundred billion dollars. (In fact, so much private money is outside Saudi Arabia and other Gulf states that it is impossible to halt private funding of extremists groups.)

The Kingdom is also experiencing a broad economic boom. Saudi oil export revenues sank to only \$34.3 billion in 1998, but they rose to \$46.8 billion in 1999, \$81.7 billion in 2000, \$63.9 billion in 2001, \$65.5 billion in 2002, \$86.1 billion in 2003, \$106 billion in 2004, and will probably reach \$157 billion in 2005. (See SAMBA, "The Saudi Economy in Mid-2005, August 2005, www.samba.com)

Distribution of income is a serious problem – as it is throughout much of the world – but Samba reports that the Saudi nominal GDP has risen from only \$145.77 billion in 1998 (a year with very low oil revenues) to an estimated \$316 billion in 2005. This is more than twice the 1998 figure.

After years of budget deficits, Saudi Arabia is now experiencing a major surplus. The budget has gone from an 8.9% deficit in 1998 to a 16.1% surplus in 2005. Moreover, official foreign assets have increased from \$69.4 billion to \$177.5 billion, and government debt has dropped from 119% of GDP to 51%.

The end result has been a major increase in government investment in all of the areas where underfunding was common in the 1990s. It has also been a massive increase in per capita income. It was \$7,437 in 1998, but rose to \$8,016 in 1999, \$9,161 in 2000, \$8,682 in 2001, \$8,728 in 2002, \$9,604 in 2003, \$11,052 in 2004, and will probably reach \$13,603 in 2005. These figures do not approach the peak reached in 1980, but this was a freak year driven by the fall of the Shah and Iran-Iraq War. In terms of real annual average per capita income, Saudi Arabia is doing well.

In fact, some aspects of the Saudi economy are doing so well that they may actually be dangerously overheating. The Saudi stock market generally increases in value by about 4-7% a year. A combination of repatriation of capital after 9/11, high oil revenue, major growth in the private sector, etc. led the TASI index to go up by 76% in 2003 and 85% in 2004 – an increase that makes the US IT boom look modest. This increase is sometimes based on a vast overvaluing of bubble stocks, although the problem is far smaller in Saudi Arabia than in places like the UAE.

Much of Saudi investment is also in productive areas like government spending on infrastructure and human services, mining and petroleum related industries, and in privatized Saudi companies in areas like petrochemicals. One key result is that Saudi Arabia has the money to pay for "guns," "butter," and "oil." It can fully fund its counterterrorism campaign without imposing a strain on the civil economy and can fully fund Aramco's efforts to maintain Saudi oil production capacity, and expand it to 12.3 MMBD. This was not possible during the period of low oil prices in the late 1990s.

It is also important to note that investment rates are high even in lean years. As SAMBA notes, Saudi Arabia has averaged an annual rate of 18.4% of GDP since 1990. A large amount of this investment has also gone to human services and to productive areas like ARAMCO. A major amount has gone to business since 2004, after six years of negligible growth in foreign lending.

The “Slack” in the Saudi Economy

Finally, it is important to note that Saudi Arabia has a great deal of slack in its economy that is not present in most foreign economies, and that there are a number of important steps it can take to deal with any major dip in oil revenues, and to ease the mid and long term pressures on its economy.

These include:

- Following up on the steps King Abdullah took while he was Crown Prince and totally eliminating subsidies to “do nothing” members of the royal family and “loyal families” that have been rewarded since the days of the Ihkwan.
- Taxing middle class and wealthy families at moderate rates.
- Taxing luxuries and non-productive service industries.
- Eliminating all government aid and subsidies to agriculture – none of which currently serve any meaningful economic and strategic purpose.
- Introducing true market prices for water, electricity, gas, and petrol for all of industry and all but Saudi Arabia’s poor. This will sharply reduce the cost of infrastructure services and the growth in demand.
- Sharply reducing labor permits for foreign labor, and removing the de facto state subsidy of vast numbers of foreign servants. Create a labor market based on hiring Saudis, not foreigners. Many of the 6.14 million foreigners in the Saudi 2004 census were foreign workers, and an extremely large percentage of the 1.93 million foreign women are menials or maids. Most of the develop world now lives without a servant class; so can Saudis.
- Accelerating the “basket” of economic reforms the Kingdom already has underway.

It is all too easy to focus on Saudi Arabia’s very real economic problems, and ignore the fact that it has as yet done little to impose the kind of solutions imposed by virtually every other government.

Summing Up

Like every nation in the world, Saudi Arabia faces major economic challenges. Part of its current success is also a matter of luck. High oil prices may still become moderate or low oil prices in the future. Trees do not grow to the sky and every economy goes through cycles -- particularly economies so dependent on a single major export or commodity.

It is not accurate, however, to argue that Saudi Arabia is somehow now poor, faces critical immediate economic challenges of the kind it did during a major dip in oil prices, or is failing to make progress in reform because it focuses more on economic reform than adopting Western political models.

The real economic challenge for King Abdullah is to press ahead with the reforms the Kingdom has already begun, accelerate them, and sustain them over time. If Saudi oil revenues remain moderate to high -- a projection that has just been made by the Department of Energy in the International Energy Outlook it issued on July 29, 2005 --

Saudi Arabia will not only sustain its present economic boom, it will have the resources and time to address the medium to long term structural problems that could have a critical effect on stability. These problems will only reach the crisis point if the government ignores them, and does not press ahead in reform.

Anthony H. Cordesman holds the Arleigh A Burke Chair in Strategy at the CSIS. He and Nawaf Obaid have written Saudi Security: Military and Internal Security Developments, which will be published by the CSIS and Praeger this fall. Anthony H. Cordesman is also author Saudi Arabia Enters the 21st Century: The Military Dimension, Westport, Praeger/Greenwood, June 2003, and Saudi Arabia Enters the 21st Century: Energy Politics, Economics, and Security in the Middle East, Westport, Praeger/Greenwood, June 2003. A wide range of detailed information on Saudi Arabia exists at the CSIS web under the "Saudi Arabia Enters the 21st Century Project" at <http://www.csis.org/burke/saudi21/index.htm>