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Saudi Arabia and the Oil Prices Challenge

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Over the past year the global oil market has experienced significant activity, particularly in the wake of sanctions imposed by the United States on Iran and developments in the global economy. For the US administration, Saudi Arabia plays an important role in countering the expected shortage of Iranian oil in the market and in moderating global oil prices. However, the Kingdom requires higher prices to meet its needs, and is the de facto leader of OPEC, which strives to raise oil prices. The price of oil (WTI) in the beginning of 2019 is about $46 a barrel. This article examines how the Kingdom attempts to maneuver in the oil market, balancing its budgetary needs at home and the need to keep in line with its American ally.

Saudi Policies in the Global Oil Market

According to the Organization of the Petroleum Exporting Countries (OPEC), as of late 2017, Saudi Arabia's proven oil reserves stood at about 266 billion barrels, which is approximately 18 percent of the world's proven oil reserves. In 2017, Saudi Arabia on average produced close to 10 million barrels per day (MMBD) of crude oil, which is about 13 percent of the global output. At this rate of production, proven reserves would last about 70 years. Although this is a hypothetical figure, since more and more oil reserves have been discovered, the Kingdom fears the day its reserves are depleted, leaving it with no alternative source of income. In 2017, Saudi oil export included about 7 MMBD (average) of crude oil and 1.4 MMBD of exported oil products. The excess production was used for internal consumption, and in addition, Saudi Arabia imported oil products in the amount of 0.5 MMBD. In 2017, the value of Saudi exports of oil and oil products was approximately $160 billion, while the price of oil (WTI) was an average of approximately $51 per barrel. The total value of Saudi exports was $231 billion. The amount of oil exported from Saudi Arabia and the close coordination with other large producers in the Gulf (Kuwait and the UAE) grant the Kingdom a leadership role in OPEC and in the oil industry.

Saudi Arabia's activity in the global oil market is affected by a set of considerations, some of which contradict each other. Its traditional strategy is to maximize long term income from oil exports until its reserves are depleted, and in the meantime to develop alternative sources of income (based on its Vision 2030). This strategy does not support excessively high oil prices at present, as those encourage the development of energy conservation technologies and alternative sources of energy among oil consumers. In Saudi Arabia, high oil prices have had the opposite effect – they have reduced the urgency to develop alternative sources of energy, such as in the field of solar energy.

However, in the short and medium term, Saudi Arabia needs high income from oil exports, which calls for relatively high prices, and that is due to the Kingdom's current budget deficit, expensive arms deals, the high cost of the ongoing fighting in Yemen, and above all, the need to avoid civil unrest, which has arisen elsewhere in the Middle East. To restrain possible unrest, in late 2017 the Crown Prince launched a citizens account program in 2017, designed to help lower and middle class families (about 10 million people, which is half the population) cope with the high cost of living. In late 2018 the Crown Prince revealed a new initiative, designed to help the young population, but it hasn't yet been finalized. The Kingdom's 2019 budget is based on expenses of some $295 billion, versus an income of $260 billion, in other words – a deficit of $35 billion. According to Western analysts, the income clause is based on oil prices of $70 or more per barrel, with an output of about 10 MMBD, a situation that does not support the government's current income figures.

Tension with the United States

For the US administration, Saudi Arabia's main role in the campaign against Iran is to increase oil exports in order to support effective sanctions on the export of Iranian oil, while maintaining global prices at a level that does not hurt US economic growth. Saudi production capacity is about 12 MMBD, which means an excess of about 2 MMBD (compared with 2017 average production). This capacity means Saudi Arabia could replace most of Iran's exports. According to OPEC, in 2017 Iran oil exported included 2.1 MMBD of crude oil and about 1 MMBD of oil products. Two thirds of oil exports went to Asia and a third to Europe. The 2017 value of oil and oil products export was about $53 billion. Iran is now striving to increase oil prices as much as possible in order to maximize its income in the short term, despite US sanctions. This is of particular importance to the regime due to demands by its population to improve economic conditions.

In April 2018, before current sanctions were imposed on Iran (May), oil prices increased almost to $70 per barrel, and the Saudi regime voiced its intent to raise prices to as high as $80-100 per barrel. This announcement sparked disagreement with the United States, as President Trump feared the high price would burden US industry and consumers and contribute to inflation and an increase in US interest rates. He tweeted "oil prices are artificially Very High! No good and will not be accepted!" In turn, the Saudi Oil Minister responded that this is due to market forces and that "there is no such thing as an artificial price." Saudi Arabia did, in fact, moderately increase oil production as of May 2018, but in early October 2018, soon before the second phase of US sanctions on Iran (November 5, 2018) also designed to affect Iranian oil export, prices reached a new height for the year of about $76 per barrel.

Within the framework of the second phase of sanctions, in order to reduce global oil prices and enable Iranian oil consumers to adjust, the US administration excluded eight countries from its ban on the purchase of Iranian oil for a period of six months (through April 2019). US oil production also increased. These events mitigated the urgency of increased Saudi oil production.

At the same time, the Saudi government's entanglement in the assassination of Saudi journalist Jamal Khashoggi on October 2, 2018 hurt Riyadh's ability to successfully confront the Trump administration in general, and certainly regarding oil prices, which forced them to comply with US demands. Saudi oil production reached 11.1 MMBD in November, a year record for 2018. On November 19, 2018 President Trump said that Saudi Arabia accepted his demands to monitor oil prices and maintain them at a reasonable range. According to Trump, Saudi Arabia is an important US ally helping to promote US strategic interests, among them the fight against Iran and against global terror. He also mentioned hundreds of billions of dollars of Saudi investments in US industry. In other words, he has no intention of sacrificing US strategic interests as a result of this affair. Oil prices that day were about $57 dollars per barrel and later continued to drop.

While Saudi Arabia played a moderating role at the OPEC conference in Vienna on November 6, 2018, it agreed to cut back total production of the organization. At the conference it was also agreed that as of January 2019 total production would be cut back by 1.2 million barrels per day, 800 million of which by OPEC countries and 400 million by non-OPEC countries, primarily Russia, which cooperates with the organization. These cutbacks were seen by the oil market as lower than expected, all the more so considering Iran was excluded because of the sanctions (over Saudi objection) as well as Venezuela and Libya because of their internal situation. Oil prices remained low even after the agreement, about $51 dollars per barrel. Later that month prices continued falling, and by the end of December 2018 the price was about $46 per barrel. The additional sharp decrease was credited to economic forecasts that predicted a slowdown in global economic growth. Given that such prices could also hurt the US oil industry, it is possible that the price is even lower than what the administration would like to see. Therefore, this price level may allow Saudi Arabia to aim at a price increase, to an agreed upon level.

In conclusion, Saudi activity in the oil industry reflects a range of economic and political interests, which sometimes contradict each other. Over the past year much tension has marked Saudi-US relations regarding oil prices, but over the past few months Saudi Arabia has coordinated its activities with the United States in an effort to support sanctions against Iran. This is evident through increased Saudi oil production and its efforts to moderate initiatives for a sharp decrease in OPEC oil production. That said, current oil prices put pressure on the Kingdom's economic challenges and make it difficult for it to meet the extent of economic reforms it announced within the targeted time frame, in addition to challenging its defense goals. Therefore, it is likely it will strive toward higher oil prices by reducing production, at least up to the level on which it agreed with the US administration. The US need to regulate production and the enforcement measures it will use might become clear before the end April 2019, when the waiver for eight states regarding the ban on purchase of Iranian oil will end.