Crucial Tests Await New Saudi Oil Council

by Simon Henderson **(/experts/simon-henderson)**

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ABOUT THE AUTHORS

Simon Henderson (/experts/simon-henderson)

Simon Henderson is the Baker fellow and director of the Bernstein Program on Gulf and Energy Policy at The Washington Institute, specializing in energy matters and the conservative Arab states of the Persian Gulf.

Brief Analysis

This week the major oil companies are expected to announce big increases in profits, a reflection of the current high oil prices which last week soared to their highest level since the 1991 Gulf War. But apart from benefiting shareholders and helping fill the depleted financial coffers of Middle Eastern oil producers, the high prices have raised fears of inflation in the developed world and likely increases in short-term interest rates. Concerns about the resulting impact on the world economy and the consequent adverse effect on oil demand could be one of the first issues to be discussed by the new Supreme Petroleum and Minerals Council (SPMC) set up without prior notice by King Fahd of Saudi Arabia earlier this month. The council, due to meet for the first time this week, will also have the final word in considering the various proposals submitted by around twenty international oil companies seeking participation in the Saudi oil and gas sector.

Oil Prices and Investment in Saudi Arabia. A year ago, it was hard to imagine that the U.S. benchmark crude, West Texas Intermediate, would top $29 per barrel as it did last week while the more widely traded Brent crude from the European North Sea is over $26.30. In January 1999 prices were around $10, and there were fears in the Persian Gulf that the local prices would collapse to around $6. The price recovery started in March after members of the Organization of Petroleum Exporting Countries (OPEC) oil-producing cartel agreed to cut back on quotas. Initially, oil ministers spoke of hoping that prices would recover to the $18-$21 per barrel range. Now they appear happy with prices over $25 and are speaking of maintaining current quotas beyond the review planned for the OPEC ministerial meeting in March. Instead quotas will be not be adjusted to allow extra production until June at the earliest. Prices of $30 and over seem inevitable.

The current high oil prices are occurring despite some cheating on quotas by OPEC members, and partly because non-OPEC producers like Mexico have also cut back. But economists are still puzzled by the firmness of the prices. Last week in London, Joseph Stanislaw, the president of the respected Cambridge Economic Research Associates, attributed the strength of prices to the unified public front of OPEC oil ministers. But he warned oil companies that prices could weaken suddenly if there was a hard-to-quantify, but probably relatively small, increase in production.

With high prices providing more domestic capital for investment, Saudi Arabia arguably needs less international oil companies to help expand its oil and gas production. The invitation for proposals in this regard was originally made in September 1998 to chief executives of U.S. oil companies invited to tea with Crown Prince Abdullah during a visit to Washington. The suggestion resulted in internal Saudi bureaucratic wrangling, with the oil minister, Ali al-Naimi, saying publicly that the state oil company, Saudi Aramco, could do all the work itself.

A small team of top executives from Saudi Aramco is now examining the relative merits of the proposals, as well as those of European companies that prepared detailed suggestions. Although the state-owned oil company employs Western advisers, the subject is so sensitive these advisors are being excluded.

The first decision of the new council could come on another issue. The edict setting up the SPMC also gave it authority over the award of a concession in the so-called Neutral Zone, an area on the Saudi-Kuwaiti coastline where revenues from the local hydrocarbon deposits are divided between the two countries. For the last forty years a Japanese company, the Arabian Oil Company, has had a concession there, but this expires at the end of this February. Several of the international oil companies that have submitted proposals have included ideas for the oil and gas fields of the area. Saudi Aramco also wants the concession. Talks with the Japanese minister of international trade and industry broke down this month because of what Tokyo regards as excessive Saudi demands for parallel investments in the kingdom, including a new railway.

Royal Rivalries? Oil industry analysts are divided on whether the establishment of the SPMC reflects growing tension at the top of the Saudi royal family. There is considerable doubt whether King Fahd, who has been in fragile health since a stroke in November 1985, is capable of actively chairing anything. Certainly Crown Prince Abdullah has been running the country on a day-to-day basis for at least the last two years. Last summer, the crown prince broke the convention of the king chairing everything by setting up a Supreme Economic Council, chaired by himself, to plan the kingdom's overall economic strategy.

The specialist magazine Middle East Economic Digest suggested last week that the SPMC shows the imprint of Abdullah. By institutionalizing decision making in such a council that incorporates senior bureaucrats, it may lessen the ability of some members of the royal family to make decisions on a whim. Yet control over the kingdom's oil policy is probably the last power that the royal family wants to share.

An alternative view is that the establishment of the SPMC undercuts Abdullah, who was relegated to his usual role as deputy chairman of this body. The edict establishing the SPMC does not mention Abdullah's Supreme Economic Council. Some Arab diplomats say that Abdullah's tightening grip on Saudi economic policy had disturbed the younger full brothers of Fahd, collectively known as the Sudairi seven.

The Sudairis (the name comes from their mother's tribe) dominate defense and internal security in the kingdom. These parts of the Saudi budget account for more than 40 percent of government spending. But in the last three years, as the low oil price hit government revenues, Crown Prince Abdullah pruned budgets, effectively stopping all new arms purchases. Analysis of the budget for 2000, announced at the end of December, shows a bigger deficit than many economists expected and suggests defense and security expenditure will increase by a comparatively large 10 percent.

Some Saudi officials quietly suggest that the Sudairis want to restrict the power of Abdullah now so that when he eventually becomes king he lacks the supreme authority usually implicit in the role. This would maintain their position now and also guarantee their eventual succession. (Abdullah is 77 this year, while Fahd is 79.)

Challenge for Washington. Although oil now takes a smaller portion of GDP in most developed economies than it did twenty years ago, high prices are damaging for consumers and, in the long term, for Saudi Arabia and other oil producers. Having more than 100 years of reserves is no good if the world is driving around in fuel cell automobiles. While it is difficult for the United States to declare that a particular price is acceptable, Washington should make it clear that current prices are unacceptably high.

But it is also necessary to help Riyadh avoid succession struggles and move toward a more open and accountable system of decision making. The Saudi economy is still heavily indebted, the level of subsidies continues to be unsustainable, and unemployment is growing. High prices for oil can promote a blindness to how much the kingdom needs a professionally run economy, open to more foreign investment. The new SPMC should be applauded if, in practice, it proves to be a mechanism for change.

London-based Simon Henderson, an adjunct scholar of The Washington Institute and author of its study After King Fahd: Succession in Saudi Arabia, runs the business consultancy SaudiStrategies.com.

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