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Saudi Arabia's Vision 2030: Reducing the Dependency on Oil

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On April 25, 2016, after decades of noting the need to diversify Saudi Arabia's sources of income, the country officially unveiled its ambitious plan: "Saudi Vision 2030." The plan, of which only part was published, was originally drafted by 31-year old Deputy Crown Prince, Minister of Defense, and Chairman of the Council for Economic and Development Affairs Mohammad bin Salman. Its goal is to reduce the kingdom's dependence on oil revenues in the long term by cutting costs and diversifying the sources of income, given that the price of oil has fluctuated widely over the years and that oil is a non-renewable resource.

The chief catalyst for the plan is Saudi Arabia's difficulty in dealing with the steep drop in its oil revenues, reflected in part in a large budget deficit and a fall in its reserves. Saudi Arabia is currently producing nearly 10 million barrels of oil a day in an effort to retain its share of the global market. Its proven reserves amount to 268 billion barrels, constituting one sixth of the world's entire proven oil reserves. Income from the oil sector and oil products accounts for the vast majority of the kingdom's revenues, and thus lower oil revenues and exceptionally high spending have caused a large budget deficit. According to figures reported in late 2015, government spending in 2015 reached $260 billion (the equivalent in Saudi riyals), compared with the budgeted $229.3 billion. Actual revenues amounted to only approximately $162 billion, compared with $190.7 billion budgeted. At the end of the year, therefore, the planned 2015 budget deficit of $38.6 billion actually amounted to approximately $98 billion (about 15 percent of GDP). The planned 2016 budget deficit is approximately $87 billion, assuming $224 billion in spending and $137 billion in revenue.

These large deficits are financed at the expense of the future by withdrawals from monetary reserves, sales of assets, and even loans. Saudi Arabia realizes that this cannot continue for many more years, and that its economic base must therefore be rebuilt from the foundation – gradually, but at a rapid pace. Bin Salman's interim goal for 2020 is to create additional resources for the budget through a massive increase in income outside the oil sector, increased efficiency, and increased taxation, so that the kingdom will not face large deficits even when the oil market is at a low, as is currently the case.

The plan also aims to address the issue of employment, both for purposes of growth and in order to reduce unemployment. While the official unemployment rate is 11.6 percent, the actual rate is higher, and economic productivity is low. Many citizens do not work but enjoy excessive salaries and benefits, while others do not wish to perform manual labor, which is assigned to foreign workers. The plan seeks to generate six million new jobs by 2030.

The ways to achieve the economic targets include the development of local economic sectors and the creation of new sources of income that are less volatile than the oil market, combined with cost-cutting measures. The sectors marked for development in the plan include mining, tourism, health, and finance. As for manufacturing, as of now, the kingdom has no significant industry that is not based on oil and oil-related products. Toward economization, cutting the budget has already begun (the 2016 budget is lower than the 2015 budget), including cuts in subsidies for fuel, electricity, and water. According to bin Salman, the plan is designed to ensure that the subsidies reach those who need them the most.

The plan also includes the security sector. The plan aims to reduce arms imports, and to replace them with more local production, which will occur through a government holding company for military industry, to be founded by the end of 2017. The proportion of arms purchases from local industry is currently only 2 percent; the long term target is 50 percent local production. There are likely other reasons for reducing dependence on weapons imports, such as the wish to diminish dependence on the United States, particularly since the bilateral relations have deteriorated in recent years. In addition, and subject to the security situation, it appears that Saudi Arabia will have to rein in its defense spending, which reached a peak in 2015 (an estimated $85 billion, 13 percent of GDP), in part due to the campaign in Yemen.

In the effort to obtain financing for the plan, the kingdom plans to issue on the Saudi stock market 5 percent of the shares in Saudi Aramco, the national oil company, whose total value is estimated at over $2 trillion. In addition, the establishment of a government capital fund for the purpose of improving management of state investments is under discussion. The fund will be given responsibility for government companies in Saudi Arabia and real estate properties, along with companies around the world that Saudi Arabia will acquire in order to facilitate the diversification of state revenues. The government will also encourage the private sector, and new partnerships between the sectors that will enable the government to bear this burden are expected.

Although the plan focuses on rescuing Saudi Arabia from its dependence on oil, it appears that active development of the oil and gas sector will continue in order to maximize revenues from it in the long term. There is also no change, at least for the present, in the Saudi Arabian policy in the global oil market. While the kingdom has a strong interest in stabilizing oil prices at a higher level, it is in no hurry to limit or reduce its production as part of an agreement between the oil producers, in whom it has no confidence. The worst scenario for Saudi Arabia is that the other producers will not fulfill their obligations (if an agreement is achieved), and will grab part of its market share. In this way, oil prices could fail to rise as expected, and Saudi Arabia's oil revenues will shrink. In addition, as a long term policy, Saudi Arabia does not support too steep a rise in oil prices that will prove to be temporary, because it will lead to accelerated development of oil substitutes and expensive oil drillings, thereby increasing the supply of energy and driving oil prices down to a lower level. Thus, the plan to reduce dependence on oil is Saudi Arabia's only escape from these long term challenges in the oil market.

Initial Implications

Theoretically, the Saudi plan represents a set of worthy goals and measures that are economically essential and critical to the kingdom's long term survival. At this stage, it is premature to assess the likelihood that the plan, based on the published data, will be fulfilled, but the goal of substantially reducing the dependence on oil by 2020 is highly doubtful. If there is a new rise in oil prices, public pressure to abandon the streamlining and cost-cutting measures will presumably increase, while under circumstances of continued low oil prices, which is one of the plan's fundamental assumptions, the kingdom will have difficulty financing the investments and processes required for accelerated development of the non-oil sector.

The main challenges to the plan concern the need to open Saudi Arabia's conservative and closed economy, and adapt it to the rules of a modern economy. The culture of entrepreneurship, essential for developing a private business sector, is very limited in Saudi Arabia, and Saudis have long been accustomed to the state being responsible for almost all of their needs. This situation has led many Saudis to take for granted the receipt of services and income. In other words, citizens of the kingdom regard oil profits as rights to which they are entitled as citizens loyal to the royal house, not temporary benefits granted by the rulers. According to this equation, if and when welfare begins to erode, loyalty in certain circles may well be undermined. The task of cutting back benefits to citizens is particularly difficult, given that Saudi Arabia must deal with the challenges posed by the regional upheaval and Iranian subversion. Thus, fulfilling the plan is a challenge to internal stability.

Promoting the plan also constitutes a personal challenge to Prince bin Salman. His rivals within the royal house, who are dissatisfied with his acquiring more and more authority, and groups in the conservative religious establishment fearful of excessive openness, especially the social elements of the plan, are liable to get in his way. At the same time, it appears that the prince is winning support from those of his own age, who account for a large majority of the kingdom’s residents (50 percent of the population in Saudi Arabia is under 25), and who hope for change. The burden of proof is on him, even as he must cope with the burden of the bloody stalemate in Yemen. Failure of the plan will harm not only his reputation and his chances of becoming king, but is also liable to further aggravate the kingdom’s economic situation and lead to internal instability.