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Believe it or not! IMF loan for Saudi Arabia?

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Would you believe that Saudi Arabia, the world's largest exporter of oil needs temporary accommodation to meet dollar shortages and might go to IMF?

The culprit is the tumbling oil price: a steep fall from US$115 a barrel in 2014 to US$43 a barrel now. Export earnings of oil exporting countries have been declining over the last two years, as demand from advanced economies has been declining. This is partly because of success from the heavy investment in America by oil companies in new shale fraction technologies, which reduced USA's dependency on oil imports; recession in Europe and Japan for nearly eight years; and the recent slowdown down of Chinese economy.

The economies solely dependent on oil export earnings have collapsed. Already two oil surplus countries have to go overseas to borrow: Qatar for US$5.5 billion and Oman US$1.1 billion.
A third one, Angola is negotiating with IMF for a loan.

The cartel

Saudi Arabia is the leader of the oil producing and exporting nations. The group is referred to a 12-member cartel, the Organization of the Petroleum Exporting Countries. (OPEC). Cartel, which is an ugly term denoting price manipulation to the advantage of producers, is defined as "an association of manufacturers or suppliers with the purpose of maintaining prices at a high level and restricting competition."

The other 11 members are: Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, United Arab Emirates and Venezuela. The USA is not a member of OPEC. World production is dominated by ten top countries, with 64% of world production. Two are the dominant producers: Russia and Saudi Arabia (each 13%). Others are USA (9%), China (5%), Iran (4%), Canada (4%), United Arab Emirates (4%) and Venezuela (4%).

The leading exporters are again Saudi Arabia: US$268.2 billion (18.5%), Russia: $152.6 billion (10.5%), United Arab Emirates: US$98 billion (6.8%), Canada: $88.1 billion (6.1%), Iraq: US$84.4 billion (5.8%) and Nigeria: US$76.2 billion (5.3%).

Smaller producers including China, India, Indonesia and Malaysia account for one third of world production. They happen to be importers as well. They are more diversified in export earnings.

A welfare state

Saudi Arabia's immense wealth in terms of stunning commercial buildings and magnificent private mansions and superb infrastructure is all due to oil money. The kingdom is also a big creditor to USA, as it holds America's bonds and treasury bills valued at US$ 750 billion.
Manual work in the kingdom is done by foreign labour, accounting for 30% of the country's population of 27 million. Gross domestic product per capita is US$ 26,000. Contribution of oil exports is 42% of GDP; and 87% of government budget is funded by revenue derived from oil exports. About 90% of export earnings are from oil. Both GDP and government budgets are at high risk with falling oil price.

There is no personal income tax levied on citizens. Foreign business houses are taxed heavily. Incomes of foreign oil companies face a tax rate at 85%. Tax revenue is used for running several welfare programs. These include housing, disability and health care. The objective is to promote a high standard of living as well as meeting all needs of citizens. Take petrol price. It costs a mere US$0.16 per litre, or roughly 60 cents per gallon. The costs of handouts are always high. The fuel subsidies cost the government US$52 billion or 8% of Saudi Arabia's GDP.

With the decline in total tax revenue, as a result of fall in oil exports income, the budget deficit was mounting estimated at 25% of GDP. The IMF recommended a mix of demand support and structural reforms, aiming at reducing oil dependency.

The latest report of IMF on *World Economic Outlook* released this month has maintained its early gloomy forecasts: Growth will only be at 1.2% in 2016, the lowest in seven years. The suggested austerity measures include cutting subsidies to domestic consumers on fuel products, water, electricity and other services. Though some measures are undertaken, a lot remains to be done. On the other hand, other non-tax revenue measures are thought about. They include privatization of government enterprises. It includes selling around 5.0% of government's oil company Aramco, worth more than US$2.5 trillion. The other 95% shares would be transferred to the Public Investment Fund.

In the meanwhile, international credit rating agencies have downgraded the kingdom's rating. The Fitch has downgraded the rating from AA to AA- and described the outlook as negative, indicating that further cuts are likely.

The OPEC knows that word demand is falling due to recession in Europe and Japan and the recent slowdown of the Chinese economy. In fact, low oil price has been a boon to many countries, poor and developed, including Fiji and Japan which have no oil resource. It has also been responsible for low inflation.

The Doha meeting

The only way to stop the fall in oil price is through cutting production. The OPEC leader, Saudi Arabia was reluctant for political reasons. The oil kingdom wants to throttle the economic strength of Islamic State , which is dependent only on the militarily acquired oil wells; of Iran, the arch rival against whom all sanctions have been withdrawn; and to make US companies using the highly expensive shale fraction technology companies to go broke, if the price is kept below US$100 a barrel.

The kingdom's objective was to weaken its enemies through falling price.

Now it knows that its own finances are at risk.

It has to control falling prices. To meet temporary shortage, the kingdom can sell its US dollar holdings, including US$750 billion worth of securities. But, it will result in fall in the value of US dollar. Since oil price is quoted in US dollar, such a step will ruin the economy further. It is a lot easier to borrow internationally. Its requirements are around US$10 billion. It is already talking to international banks.

The easiest way now open is to reduce the output. The OPEC met on April 17 to consider caps on production. Expectedly, Iran did not attend. Second, with no consensus, they agreed to meet again. The meeting is a flop. The gainers are poor countries.

We got the good news last week: aside from reduction in diesel and petrol price, the cooking gas also became cheaper!

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