Privatising Saudi Aramco - why?

by DIETER HELM

Having gone to great lengths to nationalise its oil industry in the 1970s, in order to control its resources and gain the maximum economic rents, Saudi Arabia is now in reverse gear, proposing to sell a first chunk of Saudi Aramco. Why? What is different now compared with the late 1970s? Why is it better now not to own all its industry, when it seemed such a good idea all those years ago?

The proximate reason the Saudis give is that they need the money. The idea apparently is that the Saudis are going to wean their economy off oil, by investing in a host of industries they seem to think they will have a comparative advantage in. This is the Vision 2030 plan drawn up by consultants.

Never mind that there are very few examples in history of such a state-driven transformation, and never mind that the religion-based education system and the authoritarian regime are singularly ill designed to create the skills necessary to deliver such a transformation. Even if all of this is ignored, and a bunch of consultants could come up with a credible master plan, the really intriguing question is: what could selling 5% of Saudi Aramco possibly contribute? It really isn’t worth enough to make the necessary difference.

This leaves two other possible answers. The first is that by having private investors, and having the shares listed in New York, London and elsewhere, Saudi Aramco would have to behave like a proper company. It would have to focus on its business, and stop being a political part of the state, spending on a host of political projects and carrying out what in a normal country would be deemed public expenditure.

The sad story of so many national oil and gas companies has been like this. Gazprom ended up buying media outlets to garner support for Putin, and Rosneft has been a very political company. Saudi Aramco at least had the legacy of its American private company owners before nationalisation, but it still is part of the state.

This new private sector quoted company discipline cannot but improve its corporate governance. It will have to produce clean accounts, and these will need to meet stock exchange rules. It will need to be transparent and treat its new minority shareholders properly. Much of this will prove politically painful, but then that is the point.

The second possible answer is that the Saudis know the oil game is up, and as I explain in Burn Out – the endgame for fossil fuels, the oil price is on a long run decline. Oil in the ground may be worth less tomorrow than it is today, as prices sink back gradually towards marginal cost. Selling off the family silver makes more sense when it is going to be badly tarnished tomorrow. A forward sale of oil reserves makes sense if there are enough investors who still believe that OPEC can control the market and the good times of even $70-80 a barrel are on the horizon.

There is a lot to be said for this second line of argument. What is then rather puzzling is that the Saudis do not appear to believe in the falling prices scenario. Amin Nasser of Saudi Aramco poured cold water on the notion that “the world can prematurely disengage from proven and reliable energy sources like oil and gas, on the mistaken assumption that alternatives will be rapidly...
deployed”. He may be right about the speed of alternative technologies, but if he thinks that supplies will not keep pace with demand, he is very likely to be mistaken. In the endgame for fossil fuels, as everyone realises that the price will go down, everyone will want to produce more today, hence helping to make falling prices self confirming. And if he really believes the price is going up, why sell any of Saudi Aramco in what he thinks is a low point in the market?

It is of course in Saudi Aramco’s interest to talk the prices up. But so far the attempt to rig the market since late 2104 has been spectacularly unsuccessful. OPEC’s production “cuts” have not worked. Prices fell further back below $50 as a result of the last attempt. OPEC and non-OPEC countries are increasing output in response to the falls in prices. US shale production has held up, as its costs of production has fallen. Even Canadian production has been remarkably resilient.

There may be gullible investors who will believe the Saudi Aramco line and think prices are going up, and that they will be buying an appreciating asset. Others will want to make sure they have the right weighting of Saudi Aramco shares in their indexes. It is possible to fool at least some of the investors some of the time. Selling 5% now might turn out to be a clever move, if the 5% turns out to be worth less tomorrow.

Whether the money is then well spent is another question. Apart from oil and gas it is hard to think of anything world markets buy, or would want to buy, from Saudi Arabia. Given the way tensions are winding up in the Gulf region, and given the military ambitions of the new Crown Prince, it is more likely that the money is spent propping up public expenditure, given the deficits that have now emerged, and buying arms to fight in Yemen, and to deter Iran and its client states that increasingly surround Saudi Arabia.

There is of course a more radical option. If the price of oil is going to fall, why not sell 51%, or indeed 100% of Saudi Aramco? Why not go back to the world of the 1960s? The obvious response is that the Saudi government would not want to lose control. That however is precisely the dilemma for investors. If Saudi Arabia does not want to loose control, what fate lies in store for the new minority investors? Ownership of 5% will not give shareholders much say in what happens, and since Saudi Aramco is an integral part of the Saudi Arabian state and its royal family, an investment in Saudi Aramco is effectively a bet on the Saudi Royals. Perhaps this should be spelt out in the prospectus?