

## Saudi Arabia's Lessons Learned

The economic boom in the gulf countries over the past few years — fueled by the continuous rise of oil prices between 2003 and 2008 — helped put the region on the global economic map. In some ways, the boom became captive to a “mine is bigger than yours” syndrome. Competing states embarked on advertising campaigns and hired in public-relations firms to tout their wares. Developers and rulers alike pushed artificial islands (Dubai, Abu Dhabi, Qatar, Bahrain, Kuwait), and in many places real estate became the main economic activity. Officials promoted their cities as financial hubs as a way to diversify away from oil. Hundreds of millions of dollars were poured into national air carriers and airports, which were seen both as a source of national pride and as another way to expand the energy-dependent economies.

While oil revenues were flowing, sovereign wealth funds acquired foreign assets with the flair of peacocks. The humility that typified the past was supplanted by conspicuous consumption. Yes, all that infrastructure and new property that was built still exists — but its quality and engineering is, in many cases, dubious.

In contrast, Saudi Arabia's institutional memory of the boom and bust cycle served it well during what was the kingdom's third great oil boom of the past four decades. After the high prices of the 1970s, Saudi Arabia's economy went through a long-drawn-out slowdown as oil revenues plummeted for most of the 1980s. After a spike when Iraq invaded Kuwait, prices weakened again in the 1990s, even as Saudi struggled to pay off its (large) chunk of the bill for the first Gulf War. At the height of the Asian financial crisis in 1998, oil prices had fallen to just \$12 a barrel. This meant that Saudi Arabia — which sells its precious black gold at a discount, on average — was getting just \$7 a barrel. Deficit financing was the only solution, and the government started borrowing at home and abroad. By 1999, Saudi Arabia's government debt was bigger than its economy. And then came 9/11, which drove the final nails into the coffin of the country's image. A series of terrorist attacks inside the country added to the sense of chaos. Some predicted the end of the House of Saud.

But when oil prices started to rise in 2003, Saudi Arabia was ready. For one thing, the Saudi Arabian Monetary Agency, the country's central bank, had greatly expanded the number of well-trained national staffers. Second, it had at its helm officials who remembered the bad days of low oil revenues. That meant that when the oil gushers were turned up again, money was saved and not aggressively spent as elsewhere in the region. The nation's wealth was also placed in very liquid investments,



predominantly U.S. government paper assets, rather than real estate. While other regional investment funds were buying into international banks, Saudi Arabia was purchasing U.S. government bonds, or paying down its debt. The country can tap into those liquid assets while its neighbors are struggling to sell their investments in banks, equities and companies — Saudi's debt now stands at just 13% of the total size of its economy.

Third, King Abdullah, though often criticized as being too “frugal,” has stuck to sensible spending. It is this that has saved Saudi Arabia. Even the ambitious economic cities that were announced at the end of 2005 were private-sector initiatives, not state-financed ones.

Fourth, the banking sector, thanks to its experience during the 1990s, has taken a conservative approach to lending, and remains highly unleveraged. Importantly, real estate in Saudi Arabia did not experience the same bubble that occurred in the country's neighbors; as a result consumers and lenders have been protected.

Fifth, during the boom years, Saudi Arabia invested more than \$70 billion in expanding its oil production capacity to 12.5 million barrels per day, not only to secure its future but also to address global supply imbalances.

To be sure, the two stock market slumps in 2006 and 2008 created negative wealth effects. High-net-worth businessmen have been hit by the current global financial crisis. But there is no doubt that the macroeconomic picture is solid and healthy. Over the next five years Saudi Arabia has outlined a \$400 billion spending program. In a decade or thereabouts, Saudi Arabia will become a \$1 trillion economy and will be better placed than the rest in the region to capitalize on its knowledge and strengths. During the boom years, some critics said Saudi Arabia should become more like Dubai. Now the rest of the region might want to become a bit more like Saudi Arabia.

*Editors Note: In his second article for this edition, John Sfakianakis the chief economist of the Saudi British Bank (SABB) has graciously allowed us to reproduce an article originally published in Time magazine during May.*