

Dear Loeb Judges,

*The Economist* does not often break world exclusives. But its story on January 7<sup>th</sup> 2016, that Saudi Arabia was considering selling part of Saudi Aramco, potentially the world's most valuable company, may well have been the scoop of the year. It caused a sensation in oil markets, startled diplomats and financiers, and was picked up by dozens of newspapers, including the *New York Times*, the *Wall Street Journal* and the *Washington Post*. It had geopolitical implications; the possible sale of Saudi Arabia's crown jewel revealed the extent to which falling crude prices were shaking the foundations of oil-producing nations. Even Saudi ministers and Aramco executives were shocked at the news. The company did not confirm it until a day later.

Like all great scoops, this one was the product of instinct, intuition and good judgment. Our team of journalists traveled to Diriya, the royal family's ancestral capital. In his first on-the-record interview, deputy crown prince, Mohammed bin Salman, let slip, in answer to a question about the possibility of selling shares in Aramco, that the kingdom was considering it. Our team held onto the news, checking with other members of the government that the words of a young leader with a reputation for impetuosity could be taken at face value.

We drew together a package of stories, including a cover story, "The Saudi blueprint", and a briefing explaining that Aramco was potentially worth trillions of dollars, with reserves ten times the size of ExxonMobil's, and the ability to pump more oil each day than the United States. We followed this in April with an exclusive interview with its chairman, Khaled al-Falih, which led to another scoop about possible complications with the float because of potential lawsuits against the Kingdom in America and Britain.

Our series of stories went beyond business and helped change the way policymakers consider Saudi Arabia, as well as the future of oil. The Kingdom considers the sale of shares in Saudi Aramco as the lynchpin of its efforts to create an economy less dependent on oil, with what we called "Thatcherite" reforms and investments across a wide range of technologies. This could alter the geopolitics of the Middle East. The proposed sale has also become emblematic of concerns among resource-rich nations that demand for oil will eventually peak because of actions to mitigate climate change.

We made no concessions to earn the story. Our coverage of Prince Mohammed's plans has been level-headed throughout. The theme of a young

prince in a hurry to reshape Saudi Arabia's future has been given ballast by solid reporting on the obstacles he faces. We have given him a fair hearing. But we have not pulled our punches, either.

In short, *The Economist* has never been prouder of a good, old-fashioned scoop. We hope the Loeb judges agree.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Zanny Minton Beddoes', written in a cursive style.

Zanny Minton Beddoes,  
Editor-in-chief  
*The Economist*

**Title of submission:** Saudi Aramco: The world's most valuable IPO

**Category:** Breaking news

**List of elements:**

- 1) "Saudi Arabia is considering an IPO of Aramco, probably the world's most valuable company"  
<http://www.economist.com/news/middle-east-and-africa/21685529-biggest-oil-all-saudi-arabia-considering-ipo-aramco-probably>
- 2) "The Saudi blueprint"  
<http://www.economist.com/news/leaders/21685450-desert-kingdom-striving-dominate-its-region-and-modernise-its-economy-same>
- 3) "Saudi Arabia: Young prince in a hurry"  
<http://www.economist.com/news/briefing/21685467-muhammad-bin-salman-gambles-intervention-abroad-and-radical-economic-change-home>
- 4) "Saudi Aramco: Sale of the century?"  
<http://www.economist.com/news/briefing/21685475-possible-ipo-saudi-aramco-could-mark-end-post-war-oil-order-sale>
- 5) "Saudi Aramco: The big float"  
<http://www.economist.com/news/middle-east-and-africa/21697839-how-part-privatise-worlds-biggest-company-big-float>

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# The Economist

JANUARY 9TH-15TH 2016

# Saudi Arabia

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Cambodia.....	US\$8.00	Indonesia.....	Rp77,000	Myanmar.....	US\$8.00	Philippines.....	Pesos385	Thailand.....	Baht 300
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A Thatcherite revolution

# Saudi Arabia is considering an IPO of Aramco, probably the world's most valuable company

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The biggest oil of all

Jan 7th 2016 | Middle East and Africa

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SAUDI ARABIA is thinking about listing shares in Saudi Aramco, the state-owned company that is the world's biggest oil producer and almost certainly the world's most valuable company. Muhammad bin Salman, the kingdom's deputy crown prince and power behind the throne of his father, King Salman, has told *The Economist* that a decision will be taken in the next few months. "Personally I'm enthusiastic about this step," he said. "I believe it is in the interest of the Saudi market, and it is in the interest of Aramco."

The potential listing comes as Saudi Arabia grapples with the damage wreaked on its economy by an oil-price collapse to below \$35 a barrel, as well as mounting tensions with its arch-rival Iran, following the execution of Saudi cleric Nimr Baqr al-Nimr in early January. It is just one possible step in an ambitious plan to balance the budget and throw open the country's closed economy.

Prince Muhammad made the remarks during his first on-the-record interview, on January 4th, in which he ranged broadly, from the geopolitics of the region, to his efforts to foster radical economic reform in Saudi Arabia.

[Read the full transcript here.](#)

The prince has held two high-level meetings recently on the possibility of floating Saudi Aramco shares. Officials say options under preliminary consideration range from listing some of its petrochemical and other "downstream" firms, to selling shares in the parent company, which includes the core business of producing crude.

Officials say Saudi Aramco is worth "trillions of dollars", but it is one of the world's most secretive oil companies and reveals no information on revenues and offers only limited information on its hydrocarbon reserves.

Prince Muhammad says that a listing would make the company more transparent. Diplomats say investors are already being sounded out. The talk is of first floating part of the company in Riyadh—perhaps 5%. In time that could rise, though the kingdom would continue to exercise control over the company.

The upstream part of the business would be most attractive to investors. At 261 billion barrels, Saudi Aramco's stated hydrocarbon reserves are more than ten times those of ExxonMobil, the largest private oil company. Saudi Aramco is also one of the world's lowest-cost oil producers, thanks to the ease of pumping oil in Saudi Arabia.

Speaking about Iran, Prince Muhammad defended Saudi Arabia's decision to suspend diplomatic relations on January 3rd after its embassy was set ablaze in Tehran by crowds protesting against Mr Nimr's execution. The prince denied that there was a risk of outright conflict. "A war between Saudi Arabia and Iran is the beginning of a major catastrophe in the region," he said. "...For sure, we will not allow any such thing." However, on January 7th, Iran said that Saudi warplanes had attacked its embassy in Sana'a, Yemen's capital.

Since Prince Muhammad became head of the defence ministry, and the Council for Economic and Development Affairs, just over a year ago, the country's geopolitical swagger has been coupled with plans for sweeping economic change at home. These plans include gradually eliminating subsidies on electricity, water and housing; seeking private-sector provision in health care and education; introducing a 5% value-added tax on non-essential goods; and studying the complete or partial privatisation of over two dozen agencies, including the national airline and telecoms firm.

Asked if Saudi Arabia was undergoing a "Thatcherite revolution", Prince Muhammad replied: "Most certainly."

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# The Saudi blueprint

The desert kingdom is striving to dominate its region and modernise its economy at the same time



FOR years Saudi Arabia seemed inert, relying on its vast oil wealth and the might of its American patron to buy quiet at home and impose stasis on its neighbours. But oil prices have tumbled, America has stood back from leadership in the Middle East, the region is on fire and power has shifted to a new generation—notably King Salman's 30-year-old favoured son, Muhammad bin Salman. A sandstorm of change is rousing the desert kingdom.

The visible result is the brutal treatment of dissent at home and assertiveness abroad that has just been on chilling display. On January 2nd Saudi Arabia executed 47 people. Most of them were terrorists linked to al-Qaeda but some, including a prominent Shia cleric, simply called for the fall of the ruling House of Saud. After Iranians set fire to the Saudi embassy in Tehran in protest, the kingdom cut diplomatic, trade and air links, a grave and foolish escalation in a febrile region.

Away from the headlines, however, a different assertiveness could prove equally consequential. Prince Muhammad has drawn up a blueprint designed to throw open Saudi Arabia's closed economy and government—including, he says, the possible sale of shares in the national oil firm, Saudi Aramco.

Coupling geopolitical swagger with sweeping economic change is a gamble. The outcome will determine the survival of the House of Saud and shape the future of the Arab world.

## What is Arabic for Thatcherism?

The plunge in the price of oil, from \$110 a barrel in 2014 to less than \$35 today, was partly because Saudi Arabia seems determined to protect its share of the oil market. Nevertheless, low prices are a time-bomb for a country dominated by oil and a government that relies on it for up to 90% of its revenues. The budget deficit swelled last year to a staggering 15% of GDP. Although the country has \$650 billion of foreign reserves, they have already fallen by \$100 billion.

When oil prices fell in the 1990s, the Saudis simply borrowed heavily. They were saved when China's boom sent commodity prices soaring again in the 2000s. This time no one, including the Saudi rulers, expects a return to triple-digit oil prices. Instead, they acknowledge that the economy must change. Speaking to *The Economist* this week (see pages 16-18), Prince Muhammad laid out a blueprint for reform that amounts to a radical redesign of the Saudi state.

The first step is fiscal consolidation. The goal is to eliminate the budget deficit in the next five years, even if the oil price stays low. Though there is much flab to cut, that is still a perilous undertaking which means dismantling the system according to which petro-cash, not taxes, pay for free education and health care as well as highly subsidised electricity, water and housing. More than money is at stake: this largesse has disguised how far the economy is chronically unproductive and dependent on foreign labour. It has been too easy for Saudis to avoid working, or to snooze away in government offices.

The new leadership has made a start. Spending cuts in the last months of 2015 stopped the deficit from soaring to more than 20% of GDP. The 2016 budget includes steep rises in the prices of petrol, electricity and water (though they remain heavily subsidised). The prince pledges to move to market prices by the end of the five-year period. He is also committed to new taxes, including a value-added tax of 5%, sin taxes on sugary drinks and cigarettes, and levies on vacant land.

Recalibrating taxes and subsidies is only the first step. Roughly 70% of the 29m-plus Saudis are under 30. At the same time, two-thirds of Saudi workers are employed by the government. With the workforce projected to double by 2030, the country will prosper only if the sleepy statist economy is turned on its head, diversifying from oil, boosting private business and introducing market-driven efficiencies.

The government plans to do this by getting the state out of all but its essential functions. From health and education to state-owned companies, the new Saudi leadership is looking for privatisation and the private provision of public services. It has plans for charter schools and an insurance-based, privately provided health-care system. It is looking at the complete or partial privatisation of more than two dozen agencies and state-owned companies, including the national airline, telecoms firm and power generator. The biggest fish of all is Aramco, a national icon and almost certainly the world's most valuable firm. The prince favours floating a minority stake in Aramco and opening its books to the world. He is urging his team to come up with a plan within months (see page 18).

Could such a blueprint become reality? Words are cheap and the obstacles huge. Saudi Arabia has promised reform before, only for its efforts to fizzle into insignificance. Its capital markets are thin and the capacity of its bureaucracy thinner. The investment that it needs in its young people, its non-oil industries, its tourism infrastructure and much else will not come cheap. It will not happen unless investors believe in the country's future. That confidence will be hard to build.

## The best-laid plans

One reason is that austerity on an almost Greek scale will be difficult and unpopular (though the examples of Syria and Libya are a deterrent against outright rebellion—see page 41). The state has provided generously partly to make up for the lack of political rights. Yet the royal family is reluctant to open the pressure valves that might make cuts more palatable. For all its economic urgency, the new regime shows no interest in political reform. Recent elections in which women were allowed to vote and to stand for (largely powerless) municipal councils were the idea of the late king. Nor is there a sign that the religious absolutism Saudi Arabia shares with its enemy, Islamic State, will soften. Even before the latest round, executions were at a 20-year high. Prince Muhammad waxes lyrical about the new generation. But he has little appetite to take on the conservative clergy over, say, the ban on women driving.

The other obstacle is geopolitics. As Iran has become more assertive, the Saudis have stepped in as the champion of Sunni Muslims. They have confronted Iranian-supported allies such ▶▶

▶ as the Houthis in Yemen and Bashar al-Assad in Syria, as well as Shia malcontents at home and in neighbouring Sunni-ruled countries like Bahrain.

The new leadership argues that stability requires it to send a signal to terrorists (hence the executions). It feels obliged to defend its interests by resisting Iran which, it says, is bent on re-creating a Persian empire. The argument is flawed: Saudi Arabia instead risks leading one side in a Muslim sectarian struggle it can neither win nor afford. The war in Yemen is a morass; support for Egypt and other Sunni allies is a drain. De-

fence and security already take over 25% of government spending and will eat up a growing share of a shrinking budget. Regional tensions will also deter private investment. Who would put trillions into an isolated economy in a region in turmoil?

The new regime seems to regard boldness at home and abroad as signs of a strong Saudi Arabia. Yet, though a muscular foreign policy plays well among Saudis, the economy will not thrive if the royal family ends up inflaming its region and blocking social reform at home. If Prince Muhammad is to remake his country, not wreck it, he needs to understand that. ■



## Young prince in a hurry

DIRIYA

**Muhammad bin Salman gambles on intervention abroad and radical economic change at home. But forget about democracy**

THE Al Sauds once again hold court in Diriyah, their ancestral capital that was laid waste by the Ottoman empire and is being lovingly restored as a national tourist attraction. This is where the Al Sauds forged their alliance in the 18th century with a Muslim revivalist preacher, Muhammad Ibn Abdel-Wahhab—a pact that to this day fuses the modern Saudi state with the puritanism of Wahhabi Islam. And this is where Muhammad bin Salman (pictured), the 30-year-old deputy crown prince who is the power behind the throne of his elderly father, King Salman, receives foreign guests in a walled complex.

One side of his reception room is decorated with the spears, swords and daggers of tradition. The other is dominated by a large television, showing the casual horrors of the Middle East and the repercussions of his own actions play out on rolling news: the execution of a prominent Shia cleric, Nimr al-Nimr, (and 46 others accused of terrorism and sedition, mostly linked to al-Qaeda jihadists) led to a mob ransacking the Saudi embassy in Tehran and, in retaliation, to the kingdom severing diplomatic relations with Iran.

Talking late into the night with the news left on throughout, Prince Muham-

mad discusses his country's interventionist foreign policy and its uncompromising response to terrorism and sedition. Asked whether the kingdom's actions were stoking regional tensions, he said that things were already so bad they could scarcely get any worse. "We try as hard as we can not to escalate anything further," he says; and he certainly does not expect war. But for his entourage, Saudi Arabia has no choice but to stop Iran from trying to carve out a new Persian empire.

If his defence of Saudi foreign policy was unrepentant, even more striking was his ambition to remake the entire Saudi state by harnessing the power of markets. No economic reform is taboo, say his officials: not the shedding of do-nothing public-sector workers, not the abolition of subsidies that Saudis have come to see as their birthright, not the privatisation of basic services such as education and health care. And not even the sale of shares in the crown jewel: Saudi Aramco, the secretive national oil and gas producer that is the world's biggest company (see next article).

At 80, the newish King Salman is part of the same gerontocracy that has run the country for decades. But he has entrusted much of his realm to Prince Muhammad,

who is in a hurry to awaken it from its torpor. He knows that, for all its ostentatious luxury, the country faces huge problems. The oil price has plunged. Arab states all around have collapsed. In the vacuum, Iran, the Shia power that has long alarmed Sunni Arabs, has spread its influence across the region, particularly through the militias it grooms—in Lebanon, Iraq, Syria and most recently in Yemen, Saudi Arabia's underbelly. The Arab world is confronted not just by a Shia Crescent, "but by a Shia full moon", says one confidant of the prince. As well as Shia militants, Saudi Arabia also faces resurgent Sunni jihadists: a revived al-Qaeda in Yemen to the south, and Islamic State (IS) in Iraq and Syria to the north. Both seek to lure young Saudis raised on the same textbooks and homilies that the jihadists use.

### Pillars of the House of Saud

The Al Sauds have survived by making three compacts: with the Wahhabis to burnish their Islamic credentials as the custodians of the holy places of Mecca and Medina; with the population by providing ▶▶

Also in this section

18 An IPO for Saudi Aramco?

For a transcript of the formal interview with the prince, see [Economist.com/saudi\\_interview](http://Economist.com/saudi_interview)



munificence in exchange for acquiescence to absolutist rule; and with America to defend Saudi Arabia in exchange for stability in oil markets.

But all three of these covenants are fraying. America is semi-detached from the Middle East. The plummeting price of oil, which provides almost all of the government's revenues, means the old economic model can no longer sustain the swelling and unproductive population. And the alliance with obscurantists brings threats, because they provide intellectual sustenance to jihadists, and form an obstacle even to modest social reforms that must be part of any attempt to wean the country off oil and create a more productive economy.

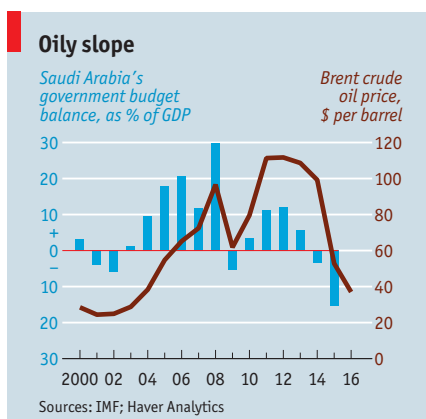
Not surprisingly, Saudi Arabia's many critics have dusted off their obituaries of the House of Saud. But for Prince Muhammad the lesson of the Arab spring, and of history, is that regimes that lack deep roots are doomed to be swept away; by implication the Al Sauds are here to stay.

Yet he knows that change must come, and fast. He has injected new energy into government, and is taking huge gambles. What he lacks in experience and foreign travel, he compensates for with confidence, focus and a battery of consultants' reports. He reels off numbers and policies with ease, pausing only to take a call from John Kerry, America's secretary of state. He speaks in the first person, as if he were already king even though he is only second in line. Over five hours King Salman is mentioned once; his cousin, the crown prince, Muhammad bin Nayef, does not figure at all, though he is in charge of internal security and may be bidding his time.

**No crisis wasted**

Such is Prince Muhammad's frenetic activity that officials reel and outsiders regard him as a bullock in a china shop. Just weeks after his father made him defence minister, fighter jets from Saudi Arabia, the Arab world's richest state, led a coalition into action against the Houthi militias of its poorest, Yemen. To critics who say he was rash to intervene in a land that has bloodied foreign armies before, Prince Muhammad says the action, if anything, came too late: the Shia Houthis, with Iran's help, had taken the country and sophisticated weapons, such as jets and Scud missiles. Scuds are occasionally fired at Saudi targets; thousands of Saudis living near Yemen have been evacuated to avoid rockets and artillery fire. In Syria he plans to send special forces against it. (The crown prince is said to be more cautious, fearing blowback from jihadists).

Prince Muhammad's most dramatic moves may be at home. He seems determined to use the collapse in the price of oil, from \$115 a barrel in 2014 to below \$35, to enact radical economic reforms. This begins with fiscal retrenchment. Even after

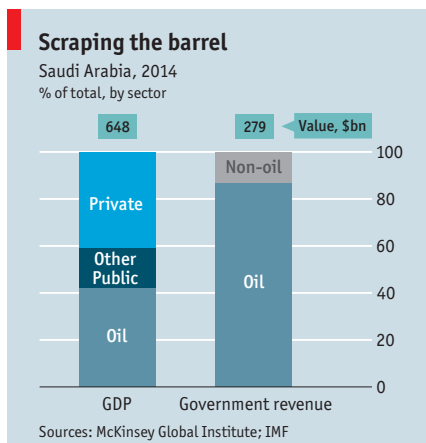


initial budget cuts last year, Saudi Arabia recorded a whopping budget deficit of 15% of GDP. Its pile of foreign reserves has fallen by \$100 billion, to \$650 billion. Even with its minimal debt of 5% of GDP, Saudi Arabia's public finances are unsustainable for more than a few years (see chart).

His budget, unveiled in December, cuts subsidies on water, electricity and fuel. These were aimed mostly at big consumers, including the myriad royal princes. "I don't deserve these subsidies," he says. Even so, Saudis witnessed the rare sight of people queuing to buy petrol before the prices rose by 50% on January 1st. This month Saudis accustomed to leaving on the air-conditioner when going on holiday will receive dearer electricity and water bills. Within five years, the plan is that Saudis should be paying market prices, probably with compensation in the form of direct payments for poorer citizens.

Ministries have halted expenditure on cars, furniture and showcase projects. The government is scrutinising allowances and overtime claims to save money. Soon Saudis will for the first time pay value-added tax of 5% on non-essentials, in a move co-ordinated with other members of the six-country Gulf Co-operation Council. Prince Muhammad is adamant that there will be no income or wealth taxes, but he plans to balance the budget in five years.

Under his "Transformation Plan 2020",



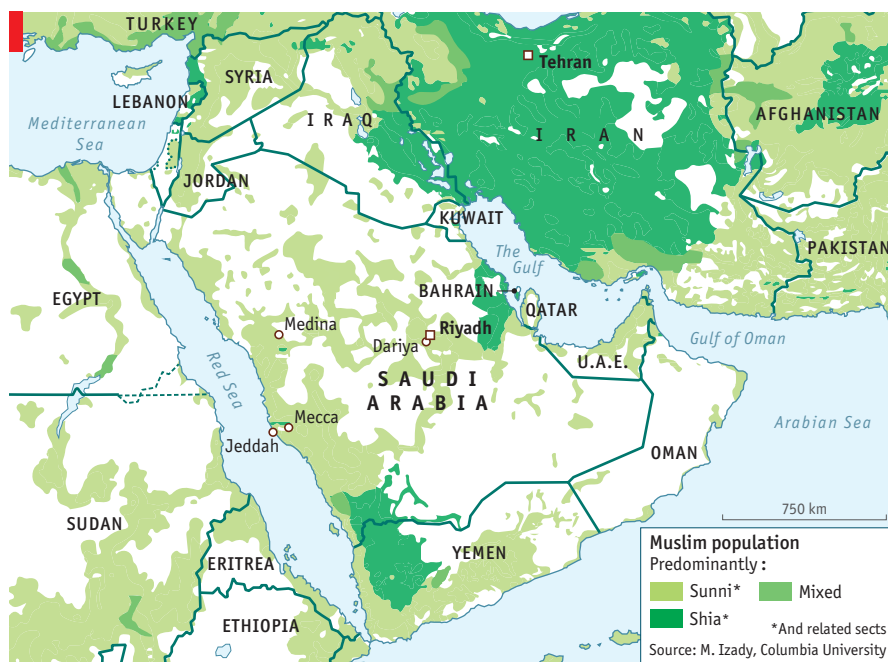
set for publication by the end of the month, the prince wants to develop alternatives to oil and drastically to cut the public payroll, which acts as a form of unemployment benefit. To do so he wants to create jobs for a workforce that will double by 2030. Ministers speak of doubling private education to cover 30% of students, establishing charter schools and transforming public health care into an insurance-based system with expanded private provision. In addition to Aramco, the prince wants to sell stakes in state assets from telecoms to power stations and the national airline. The government is to sell land to developers, such as the 4m square metres it owns around Mecca, the most expensive real estate in the world. The prince sees huge promise in developing Islamic tourism to the holy sites; he hopes to boost the 18m annual visitors to 35m-45m in five years.

Sceptics abound. Reform has long been talked about but never implemented. Prince Muhammad's ministers are astute, have PhDs from Western universities and speak the jargon of key performance indicators, but much of the government is deadweight. Even the unemployment figures are subject to doubt. "Few bits of the bureaucracy actually function at a high level," says a Western diplomat. Even senior advisers question the kingdom's capacity to find and absorb the trillions of dollars on which the plan is predicated.

In Jeddah, the commercial capital on the Red Sea, some businessmen remain sceptical, and speak more of exporting their wealth than investing it in the country. There is also suspicion of hidden motives. With each new elderly monarch, they say, favoured sons have indulged in self-aggrandisement, leaving courtiers to disguise their acquisitions as privatisations and economic reforms. Media reports of Prince Muhammad's lavish parties in the Maldives and the crown prince's house-hunting for a Sardinian villa worth half a billion euros are fodder for social media, of which Saudis are keen users.

As the man who ultimately controls the Public Investment Fund, the destination for many assets to be sold, and who has taken direct oversight of Aramco, the prince is already the subject of some muttering. What is true is that, for all his talk of transparency, his government continues to treat royal and state expenses as one and same; the royal component is a state secret.

A bigger challenge for the reformers is the fact that the prince's dizzying changes amount to, in effect, a rewriting of the Saudi social contract. Why, mutter some Saudis, should we tighten our belts when the princes continue to enjoy untold riches? And for all his boldness in economic matters, he remains obtuse when it comes to political liberalisation that might help secure consent for the economic revolution. A tiny number of women have recently



10% in 2015, and is set to rise again in 2016.

Drumming up allies, including the 34-country counter-terrorism coalition that the prince announced in December (to the bemusement and surprise of some of its putative members) is proving costly. It has recently promised \$8 billion for Egypt. Saudi Arabia is financing a proxy war in Syria and waging a full-scale one in Yemen, which has dragged on longer than initially flagged. Nevertheless for some, the sight of Saudi Arabia standing up forcefully for Sunnis against Iran is part of the antidote to the jihadists' poisonous ideology.

### Uncle Sam, we need you

Surprisingly, perhaps, for a Saudi royal with no Western education, Prince Muhammad speaks about America passionately. "The United States has to realise that they are the Number One in the world, and they have to act like it," he says; the sooner America steps back into the region—even with boots on the ground—the better.

Prince Muhammad's schemes do not appear to be inspired by ideology. Many of the ideas he is pursuing have lurked in ministers' drawers for years. Others follow examples from elsewhere, be it charter schools in America, public-private partnerships in Britain or the abolition of fuel subsidies in Egypt (and Iran). Instead they are born of necessity. The conjunction of a fall in oil prices, a geopolitical crisis and a hyperactive prince afford a once-in-a-generation chance to modernise the country.

The Arab spring has shown time and again that post-colonial Arab states are singularly dysfunctional (see page 41). That raises serious doubts about Saudi Arabia's ability to reform. But the regime has little choice: its survival may depend on it. ■

► campaigned for and won seats in municipal elections, under changes brought in by the late King Abdullah; who more than a decade ago had promised Saudis "true democracy" in 20 years. It is nowhere in sight.

Government repression has intensified. "It has never been this bad," says one campaigner for women's rights. Indeed, counter-terror legislation passed in 2014 makes virtually all dissent a terrorist offence. The evidence is all around: lawyers representing troublesome clients have found themselves behind bars; preachers who used to pronounce against corruption stick strictly to their anodyne scripts; and stand-up comedians have stopped poking fun at royals. Tellingly, more people have been executed in King Salman's first year in office than in any of the previous 20.

In a country where concerts, public movies and female performances are banned, the prince talks of the "entertainment crisis", and about his own children lacking things to do. Here and there, he seems ready to try to loosen the grip of the clerics. His latest education minister, Ahmed al-Eissa, is an academic whose book on the dreadful state of Saudi schools, which he blames in part on the restrictions placed by "religious culture", remains banned in the kingdom. Private schools, still barred from teaching evolution, would have a freer hand to set their curriculum and choose pedagogic materials beyond those designed by the clerics.

The prince says that he supports women working, not least to reduce the fertility rate: "A large portion of my productive factors are unutilised," he says. "I have population growth reaching very scary figures." These days Saudi Arabia has more women in the workplace, but female labour-force participation is still very low, at 18%. Prince

Muhammad thinks women are not taking full advantage of the opportunities they already have: "A large percentage of Saudi women are used to the fact of staying at home. They're not used to being working women." Still, he is in no mood to challenge the ban on women driving—even though some might want to lay off their chauffeurs in such straitened times. "I do not want to get involved in this issue as it is Saudi society that will decide whether to accept it or not."

The country's regional assertiveness also presents a threat to the planned transformation. Spending on defence and security, has grown from 7% of GDP in 2012 to

### Saudi Aramco

## Sale of the century?

DIRIYA

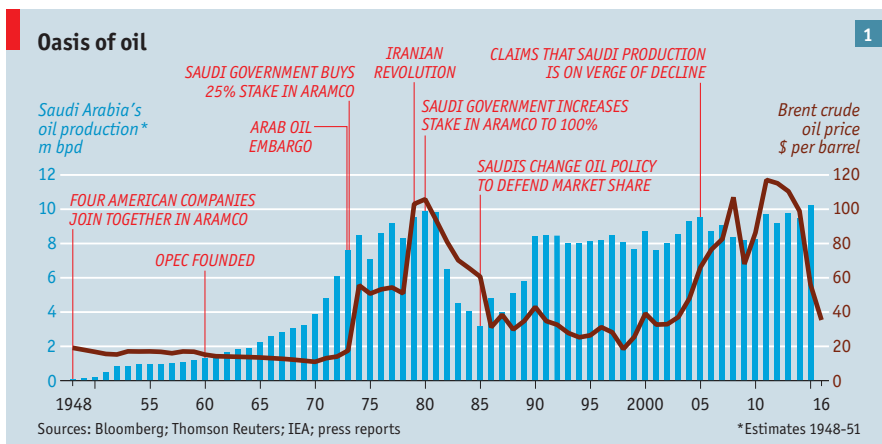
### A possible IPO of Saudi Aramco could mark the end of the post-war oil order

"THE amounts of oil are incredible, and I have to rub my eyes frequently and say like the farmer: 'There ain't no such beast.'" So wrote an American oilman in the Persian Gulf a few years after the discovery in 1938 of a gusher of oil from Saudi Arabia's Well Number Seven, 4,727 feet (1,440 metres) below the desert floor.

You could say the same today about Saudi Aramco, the state-owned firm that for decades has had exclusive control of Saudi Arabia's oil and is the world's biggest, most coveted and secretive oil company. On January 4th the kingdom's deputy crown prince, Muhammad bin Salman,

told *The Economist* that Saudi Arabia was considering the possibility of floating shares in the company, adding that personally he was "enthusiastic" about the idea.

It was a stunning revelation. Officials say options under preliminary consideration range from listing some of Aramco's petrochemical and other "downstream" firms, to selling shares in the parent company, which includes the core business of producing crude. The staggered nationalisation of the Arabian American Oil Company (Aramco), made up of four big American firms, in the 1970s was emblematic of a wave of "resource nationalism" that has ►►



have barely budged since the late 1980s, are overstated. Internal documents about them are “phenomenally closely guarded secrets” says a local observer.

The company does not report its revenues. Its fleet of eight jets, including four Boeing 737s, and a string of football stadiums suggest that it is not run on purely commercial lines. It is the government’s project manager of choice even for non-oil developments, and runs a hospital system for 360,000 people. A listing would require it to become more transparent.

But even with greater disclosure, minority shareholders may play second fiddle. The company is integral to the social fabric of Saudi Arabia and the survival of the ruling Al Saud dynasty, providing up to nine-tenths of government revenues. Cuts in its output have been a foreign-policy lever through which OPEC, the producers’ cartel, has often sought to rescue oil prices.

Investors in Russia’s Gazprom, another national champion, have watched in frustration as the company has been used as an arm of the Russian foreign ministry. Elsewhere, selling stakes in national oil companies has had mixed results.

Prince Muhammad’s desire for reform fits a pattern that some consider reckless. Saudi Arabia has recently forced OPEC to maintain production despite oil falling from a peak of \$120 a barrel to below \$35. Its decision on January 3rd to suspend diplomatic relations with Iran, a fellow OPEC member, makes it harder for both to agree on production cuts, though Saudi officials are in any case adamant that they have no intention of rescuing prices.

Others believe Saudi Arabia’s strategy makes sense. They think it wants to protect its share of the global oil market by driving high-cost producers to the wall at a time when unconventional forms of oil, such as American shale, have had gushing success.

Another threat is alternative forms of energy, such as wind and solar, which may well challenge fossil fuels. Selling shares in Saudi Aramco could thus be intended to cash in before the “decarbonisation” of the economy starts to gain credibility. It would also fit with a trend that has started to transform the oil industry for the first time in half a century—denationalisation.

Paul Stevens of Chatham House, a British think-tank, says a cadre of well-educated technocrats from oil-producing nations are wondering whether their national oil companies are “ripping us off”, through corruption or inefficiency. Brazil’s corruption-plagued Petrobras proves that public markets are no guarantee of probity. But as in Mexico, which is opening up its oil industry for the first time since 1938, many want to impose market-based checks and balances, so that no company can operate as a state within a state. If that happens to Saudi Aramco, the biggest of them all, it will have global repercussions. ■

► helped define the industry (see chart 1).

Aramco is worth, officials say, “trillions of dollars”, making it easily the world’s biggest company. It says it has hydrocarbon reserves of 261 billion barrels, more than ten times those of ExxonMobil, the largest private oil firm, which is worth \$323 billion. It pumps more oil than the whole of America, about 10.2m barrels a day (b/d), giving it unparalleled sway over prices. If just a sliver of its shares were placed on the Saudi stock exchange, which currently has a total market value of about \$400 billion, they could greatly increase its size.

Prince Muhammad says a listing would not only help the stockmarket, which opened to foreigners last year. It would also make Aramco more transparent and “counter corruption, if any”. A final decision has yet to be taken. Yet the prince has held two recent meetings with senior Saudi officials to discuss a possible Aramco listing and diplomats say investors are being sounded out. The talk is of at first floating only a small portion of the company in Riyadh, perhaps 5%. In time that could rise—though not by enough to jeopardise the kingdom’s control of decision-making.

The aim would be to foster greater shareholder involvement in Saudi Arabia; a senior official said there was no intention of surrendering control of Aramco or its oil resources to foreign firms. But it is part of a frenzy of reforms proposed by the prince that his government is rushing to keep pace with. “Everything is on the table. We are willing to consider options we were not willing to get our heads around in the past,” an official says.

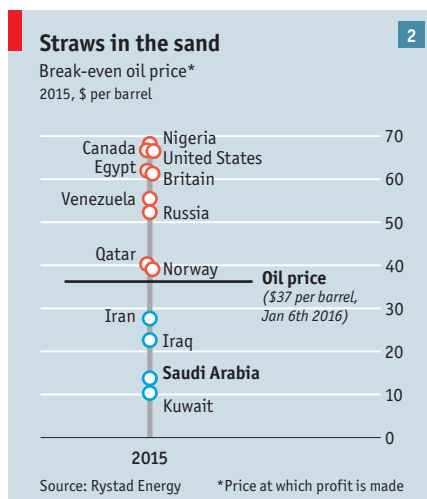
For many investors, a listing of Aramco, however partial, would be a prize even at today’s low oil prices. Its “upstream” business is mouth-watering. Rystad Energy, a Norwegian consultancy, says no other country except Kuwait can produce oil at a lower break even cost (see chart 2).

By the standards of national oil monopolies, analysts say that Aramco is well run. In the 1940s and 1950s, when the American consortium recruited young Saudis, it was an “unlikely union of Bedouin Arabs and

Texas oil men, a traditional Islamic autocracy allied with modern American capitalism”, writes Daniel Yergin in “The Prize”. Under American ownership, it built towns with schools, wiped out malaria and cholera, and helped farmers become entrepreneurs, officials recall, explaining why it was popular with Saudis.

It was a different story in Iran and elsewhere, where citizens grew sick of the colonial-era concessions taken by British and French firms, and a wave of nationalisation began. The Saudis, having declared their first 25% stake in Aramco in 1973 “indissoluble, like a Catholic marriage”, were unable to resist the tide. Full nationalisation of Aramco came in 1980. But an American business ethic survived. Just over a decade ago Matthew Simmons, an American banker, argued that Saudi wells were past their prime and that production would soon peak. Yet Aramco has increased output by more than 1m b/d in the past five years, reaching record highs. “They’ve proven their resilience,” says Chris DeLucia of IHS, a consultancy.

Questions surround the company, though. Mr DeLucia says 87% of its output is oil; it needs to develop more gas to satisfy the country’s needs for cleaner, cheaper power. Some argue that its reserves, which



► try used to gerontocratic rulers should make it easier for him to motivate young people, and social media give him better access to the pulse of the country. But with oil revenues weak and unemployment at 11.6%, the chances of disillusion are strong.

That is why he will have to address some of the questions hanging over the reforms when he reveals the National Transformation Plan, fleshing out his vision, in late May or early June. Foreign executives in Riyadh, impressed by the urgency with which Prince Muhammad's economic council appears to be slashing government waste, say concrete steps are needed before investment will come in.

"The big change here is that they've recognised 'We're inefficient, we're corrupt and we need to change,'" says Paddy Padmanathan, chief executive of Acwa Power, a Saudi electricity-generator which hopes to benefit from a pledge to produce 9,500 megawatts of renewable energy. He lauds the cutting of subsidies for public services such as electricity. But he adds that to attract investment the government will need to clarify the privatisation plans for its util-

ities, and show how they can balance their books. Investors "don't want to rely on a macho government saying 'Trust me, I will pay,'" he says. Another businessman says the country needs labour-market reform so that it becomes politically possible to fire Saudi employees who fail to do their jobs. "If you fired 20 Saudis who didn't turn up for work, you'd find yourself in a Twitter storm," he says.

Ultimately, the chances for success may depend on the power of the prince himself, who has amassed enormous control over policymaking since his 80-year-old father, Salman, became king last year. But he remains only second in line to the throne, and has a stalemate in Yemen counting against him. "This is not a dream, this is a reality that will be achieved, God willing," he says. But when the sums involved are in the trillions of dollars, the neighbourhood is fraught with tension and the reforms require the tearing up of a social contract to succeed, the burden of proof is high. Saudi Arabia has promised diversification away from oil for decades. The prince still needs to prove that this time is any different. ■

the company to promise a steady stream of forward income to shareholders.

The company is also likely to grow. In its oil and gas business it seeks a global stage rather than a domestic one, Mr Falih says. The company is giving serious consideration to investments in liquefied natural gas and other gas-related projects abroad.

At the downstream end of the business, Aramco plans to expand in Saudi Arabia and beyond. The chairman says it plans to build up domestic businesses in chemicals, power and renewable energy. It will also create subsidiaries that will build oil rigs and offshore platforms, and maintain and repair supertankers. Some of these could later be spun off. Elsewhere, it aims to broaden its presence in fast-growing emerging markets by refining oil, marketing it and turning it into petrochemicals.

In the long term, the success of the strategy will depend on the future level of demand for hydrocarbons. Mr Falih says that many policymakers in Saudi Arabia think that because of climate change, rising fuel efficiency and other factors, oil demand will probably peak before the supply starts to run out. The timing of peak demand is unclear, but whether it is 15 or 40 years away, he says the pressure is on to transform the Saudi economy: "If we end up being too anxious and calling it sooner than it really happens, it's going to be for our betterment, because we will be ready sooner than others." But he adds that barring "a game-changing technology breakthrough", oil will be in demand for decades to come as a transport fuel and as a feedstock for advanced materials, petrochemicals and plastics.

The hazy future should not deter investors from buying Aramco shares, Mr Falih says. Demography, mobility trends and urbanisation all require copious amounts of fuel. And oil, he says, is still the most convenient source of energy. ■

## Saudi Aramco

# The big float

RIYADH

## How to part-privatise the world's biggest company

THE centrepiece of Saudi Arabia's plans to transform its economy is the blockbuster sale of a stake in Saudi Aramco, reckoned to be the world's most valuable company. The government hopes it will put a value on Aramco of about \$2 trillion. The proceeds will be central to the country's plans to create a war-chest to buy non-oil assets from around the world and complement volatile oil revenues with, it hopes, steadier investment income.

But in an interview with *The Economist* on April 26th, Aramco's chairman, Khalid al-Falih, noted that potential complications in the sale of the shares mean its final form is not yet decided. An initial public offering (IPO) would offer to investors reliable dividends, from a country that produces one in every eight of the world's barrels of oil, and the chance to take a share in a company transforming itself into a "global conglomerate". But the size of the potential stake is unprecedented—\$100 billion, or four times the size of the biggest IPO anywhere in the world to date, that of the Chinese e-commerce firm Alibaba in 2014. Only the largest stockmarkets, like New York and London, could handle the sale (some shares would also be offered in Saudi Arabia). That throws up potential le-

gal problems that could have "unintended consequences", Mr Falih says.

A listing in New York, for example, would raise the possibility of "frivolous lawsuits" against the kingdom, he says. Analysts have already noted the Saudi government's anger over a bipartisan bill before America's Congress, which the White House has threatened to block (though a veto might then be overridden), which would let families sue the kingdom over the terrorist attacks of September 11th 2001. Among the 19 hijackers were 15 Saudi nationals. The Saudi government has always denied involvement. The bill could weaken sovereign-immunity defences, leading to a possibility that a listed Aramco could be exposed to legal action. A London listing, meanwhile, might lead to awkward questions about the reach of British authorities into a company's global revenues and assets.

The IPO would enable investors to buy shares in the Aramco parent company. That whets their appetites, because it includes access to the world's most lucrative oilfields. Though Mr Falih notes that the reserves are constitutionally the property of the kingdom, he says that a concession and an appropriate fiscal regime would enable



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