

Why The IMF Is Wrong About Saudi Arabia Needing \$85 Oil



Once again, the International Monetary Fund (IMF) has made outlandish and inaccurate claims that Saudi Arabia needs—absolutely NEEDS—to push the price of oil higher to fund its government. This time, the IMF claims Saudi Arabia needs the price of Brent to be at least \$85 per barrel. The problem with this claim is that it inaccurately implies that Saudi Arabia must work to achieve higher oil prices. However, this isn't true and Saudi Arabia does not base its oil policy on the budgetary break-even price per barrel of oil.

In September, the IMF forecast that Saudi Arabia needed \$73 per barrel. Back in the fall of 2017, I explained the faults in IMF logic when it claimed that Saudi Arabia needed \$70 per barrel oil to balance its budget. Among the misunderstandings underlying the IMF calculations, I highlighted that:

1. Aramco oil revenue and Saudi revenue from Saudi Aramco are not interchangeable
2. The 2017 IMF forecast seemed to ignore the tax rate on Aramco

3. Aramco has the lowest cost of production
4. Saudi Arabia had—and still has—significant cash reserves
5. The Saudi government is trying to spend less on welfare expenses
6. Saudi Arabia has easy access to cheap debt
7. There is nothing wrong with Saudi Arabia running a deficit, especially while interest rates are relatively low
8. Historically, Saudi Arabia has sought to maintain reasonable oil prices instead of prioritizing only high prices, because high oil prices lead to global recessions which depress oil demand

Now, we know even more about Saudi oil revenue and how it is determined. When Aramco released a bond prospectus at the start of April, we learned many of the company and the kingdom's financial secrets. Among them, we learned that the government funds about 63% of its budget from Aramco through a mixture of income tax (at a 50% rate), royalties (a marginal rate) and dividend. The royalties depend on the amount of oil produced and the price of Brent. The income tax is largely impacted by the price of oil as well. However, the dividend is adjusted quarterly.

Essentially, the dividend is used as a quarterly check to the government to cover whatever the government needs after Aramco's income taxes and royalties and after the government's other sources of revenue. In the first quarter of 2019, the government miscalculated how much it needed in dividend and took too much from Aramco. This led to a \$7.41 billion surplus for the government in Q1 2019, despite oil prices that ranged from \$54 to \$69. Clearly, in Q1 the Saudi government did not NEED \$85 oil.