Saudi Arabia's diversification drive

Riyadh takes Uber stake as sovereign fund moves ahead

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The April approval of the National Transformation Programme (Vision 2030) aims to reduce Saudi Arabia's dependence on oil. It will see the Public Investment Fund – the sovereign fund dubbed the Saudi 'megafund' – take its place among the hierarchy of the kingdom's ambitious development targets.

These include almost tripling non-oil revenues by 2020, reducing public sector wages and subsidies, expanding the use of public debt, and aggressively restructuring and diversifying the national economy.

The PIF is expected to expand to $1.87tn from an estimated $160bn currently (and $94bn based on official figures last year) as a result of transfers of government assets, including state-owned oil company Saudi Aramco, in effect making it one of the world's largest institutional investors.

This is a bold undertaking. But it also raises the question of whether prioritising the PIF's expansion will ultimately be in the best interests of Saudi Arabia's economic transformation.

Economic slowdown

Since the slide in oil prices starting in August 2014 – in part attributable to the kingdom's decision to maintain production levels and therefore market share – the government has been forced to reduce spending levels, significantly draw down fiscal reserves, and institute a global debt programme.

This has left Saudi Arabia facing a critical challenge, accentuated by lower oil prices – how to stabilise the fiscal balance and reduce its dependence on oil through economic diversification, all the while slowing reserve depletion and increasing savings.

Such challenges are not alien to sovereign funds as instruments of macroeconomic policy. The Saudi Arabian Monetary Agency, the kingdom's central bank, has served both stabilisation and savings functions.

With assets once in excess of $740bn, $616bn at end-2015, one of SAMA's roles is to manage the Saudi fiscal buffer – now around $500bn – to mitigate gaps between revenues and expenditure.

A deal in June under which the PIF took a $3.5bn stake in online transport company Uber and two seats on the company's board at first sight may have appeared curious to some observers. In an era of expanding urbanisation and increasing activism on climate issues, Uber's networked model of mobility services could be viewed as challenging the very foundations of Saudi Arabia's oil economy.

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However, a sizable investment in Uber offers the kingdom a long-term financial hedge, as well as a presence on the board of a company that could significantly enhance its competitiveness for years to come.

Investment objective

The PIF does not maintain a website and has not formally disclosed even basic information about its organisation and leadership, sources of capital, investment policy, or governance structures.

Based on Vision 2030 documents, its investment objective is to diversify national assets and to increase the efficiency and return on investments by taking stakes in large global firms and emerging technologies.

Nevertheless, the Fund's projected size, ambiguous mandate and obscure investment policy, and eclectic mix of large domestic and foreign assets, will challenge its management and ability to build effective investment and risk management capacity. Not economies but diseconomies of scale may result.

In addition, size, investment concentration, and an active approach to monitoring will strain its ability to sustain an independent approach to governance.

It will also increase the risk of investment decisions becoming politicised or unduly influenced by factors beyond financial and economic criteria.

Economic re-engineering

Vision 2030 is a highly aggressive platform for economic re-engineering, and its success will depend on Saudi institutions' ability to implement it effectively. The triple challenges facing the kingdom – stabilisation, savings and development – persist.

Any consideration to create focused, separately mandated funds has been displaced by a restructured and expanded PIF under the control of Deputy Crown Prince Mohammed bin Salman. But is 'mega' better? Even if so, it will increase rather than reduce the risks already inherent in Vision 2030.

Either way, the PIF is poised to become a leading actor in global finance. It should lead by example by focusing its investment strategy, articulating its governance model, carefully defining its mandate relative to other Saudi institutions – such as SAMA – and clearly and consistently communicating its investment policy to global markets. ■

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