

## Chapter 2

# Reforms and Economic Planning

*So many worlds, so much to do, so little done, such things to be.*  
Tennyson

### Difficult Decisions Being Taken

In the space of a few years since the first edition of this book in 2005, the Kingdom has witnessed some fundamental changes having taken place, which few would have predicted to happen so soon. The entry of Saudi Arabia to the World Trade Organization in 2005 was probably one catalyst to speed up domestic economic and administrative reforms, but the momentum for change was already in the making, primarily driven by King Abdullah bin Abdulaziz. Upon succeeding to the throne in August 2005 following the death of King Fahd, the Custodian of the Two Holy Mosques (the King's official title), King Abdullah embarked on a series of domestic reforms, the outcome of which are not yet fully certain but which will determine the direction and pace of Saudi economic development over the next few decades. The outcome is not important just for Saudi Arabia but also for the wider world given the Kingdom's strategic geopolitical importance in the world and its enhanced role in such bodies as the G20 bloc and multilateral organizations like the International Monetary Fund and the World Bank. Saudi Arabia continues to play a significant role in energy matters, possessing around a quarter of the world's proven oil reserves.

### Economic Diversification Remains Critical

Reducing dependency on oil revenues, however, remains a key government priority. This challenge exists for Saudi Arabia, which under a planned capacity output and production level of 12.5 mpbd, could theoretically cease to export in the next 50–60 years if global consumption continues to grow on a linear path. The solution seems clear enough: to develop an economy characterized by growing diversification of production and income, evolve inter-sectoral linkages and expand regional and

global economic integration. Domestically, the Saudi government will continue to emphasize its core development goals of raising the standard of living of its citizens, improving the quality of their lives and enhancing their technical capabilities. The historical pattern of development plan allocations reflects the above goals. At the same time, the role of the private sector would be enhanced as a key development growth enabler. Economic diversification will not be easy. For the foreseeable future, the Kingdom would still heavily depend on hydrocarbon natural resources and its derivatives for economic output as well as public finances. This dependence has left fiscal policy at the mercy of cyclical and unpredictable developments in the world's oil markets. During the period 2005–2010, average oil prices fluctuated from the lows of \$27 pb to the highs of \$147 pb, creating uncertainties in Saudi budgetary planning. Notwithstanding the economic progress made by the Kingdom, and its relative resilience in the face of the 2008–2010 global financial crisis, some key challenges remain, especially in meeting the needs and aspirations of a fast-growing and young population. As such, the Kingdom, in common with other major hydrocarbon resource-based economies, has a limited window of opportunity which exists before some critical “crunch points” arrive when support from hydrocarbon production levels off, and eventually declines. Given the significance of Saudi oil reserves, the crunch point might be later than nearer. Compelled with rising global demand for clean and alternative energy sources, Saudi Arabia could be faced by competing environmental-led shifts in global energy demand towards coal, gas, biofuel and nuclear energy. For Saudi Arabia, such changing hydrocarbon energy balances will underpin the dynamics of the transition from a depletion-led development economic model to a sustainable development model. Structural economic reforms are key to this effort being successful.

### *Reforms at Centre Stage*

A nation's economic transformation, as different models around the world from both the East and West illustrate (e.g. Malaysia, Singapore, Poland, Hungary, Chile, Turkey), depends on implementing appropriate regulatory and legal frameworks most suited to that particular country, and then allowing the competitive pressures of free market forces to determine the optimum allocation of resources needed by society. The excesses of the financial markets during the past few years have prompted international government intervention with the primary aim of strengthening regulatory oversight and reducing excessive risk-taking.

King Abdullah has recognized in public that governments must build not only their country's physical infrastructure but also a new social, civil and political infrastructure so that Saudi citizens can participate fully in creating towards and benefiting from a new economy. As such, opportunities are being made for the private sector to shape public policies that will help them to grow. Opportunities are also being created for the different regions of the Kingdom to express the socio-economic developments of their region through municipal elections. King Abdullah has also

ensured that opportunities are also made for Saudi women to meaningfully participate in the development of society. If it is true that governments must change and be more responsive, it is equally true that civil society institutions must also change, and the King has publicly called for such reforms stating that “the Kingdom cannot remain frozen while the world is changing around us” and vowed to move ahead with political and economic reforms (Arab News, 2 April 2006). For economic reforms to take root and be sustained, some measures of political reforms are necessary. Once again King Abdullah has taken the lead to ensure that there is political stability in the case of leadership succession by issuing a new succession law in 2006 that would facilitate a smooth transfer of power and remove uncertainty caused by the inability of a King or a Crown Prince to run affairs of the State as a result of poor health. The new succession law went further than King Fahd’s 1992 decree on succession, which had established the precedents that grandsons of King Abdulaziz, not only sons, were legitimate claimants to the throne, and also that the King had the prerogative to choose and to withdraw approval for the Crown Prince (Alfaisal, 2007). Under King Abdullah’s succession law, a committee of senior princes would be appointed to select future generations of Kings and Crown Princes and this committee – called the Allegiance Committee – has powers to vote for choosing its own candidate for Crown Prince, and not that for the King (Saudi Press Agency, Oct. 2006). In effect, the new political reforms implied institutionalizing the succession process and bringing stability through an evolution of the role of consultation based on Islamic principles. The processes of change and reform in Saudi Arabia have picked up pace over the past few years and have opened the door for more participatory values in the Kingdom that are suited to its social structure, especially in the area of shared decision-making and checks and balances.

This has highlighted itself in two areas that affect the lives of Saudi citizens: the workings of the Consultative Council or “*Majlis Al Shoura*,” and the judicial system. In the inaugural session of the new *Majlis Al Shoura* in March 2008, King Abdullah declared that no one in the country was above criticism, including himself, and stated that the Kingdom always respected responsible freedom, and encouraged the *Shoura* members to play their role to that end. The *Majlis* seemed to have taken this to heart and initiated a policy of inviting key Saudi ministers to address the council on matters of public interest, especially on economy and labour, to discuss issues such as the government’s desire to increase the number of Saudis in the workplace or the so-called *Saudization* policy.

The *Shoura Majlis* profile rose even further during the aftermath of the flood disasters that overtook the port city of Jeddah in December 2009 when many people were killed following a flash flood. Public anger at perceived incompetence and corruption in project tendering prompted the *Majlis* to start hearings on the causes of poor infrastructure planning and to apportion responsibility and blame based on the direct instructions of the King (SPA, Jan. 2010). Grass-roots volunteer movements to alleviate the consequences of the Jeddah natural disaster were also a first for Saudi Arabia’s civil society and established the foundations of direct citizen participation, something that had been lacking before.

## ***Transforming the Judicial System***

In February 2009, King Abdullah reshuffled the Kingdom's cabinet, changing four ministers and appointing for the first time a woman, Nora bint Abdullah Al Fayez, as Deputy Minister for girls' affairs at the Ministry of Education. Familiar faces such as the Ministers of Finance and Petroleum remained, but it was the judicial changes that attracted most attention, with the appointment of former *Shoura* Chief Bin Humaid as Chairman of the Supreme Judiciary Council and Abdulaziz Al Kelya as Chief Justice of the Supreme Court. A new Justice Minister was appointed—Mohammed Al Eissa and further changes were announced at the Court of Grievances and the Court of Appeal. The aim was to establish a more dynamic and proactive judicial environment by building up on the process of settling disputes through specialized commercial courts and appeals courts, and bring the Saudi legal system more in line with international practices. Civil courts would continue to handle family and personal conflicts. The judicial reforms were greeted positively by foreign companies who had previously complained at the lack of specialized commercial courts to hear disputes involving non-Saudi entities, and the lack of appeal to rulings. In March 2010, the Saudi Supreme Judicial Council decided to open commercial court branches in all major Saudi cities, and in a further land mark decision the Kingdom is set to bring in a new law to allow women lawyers to argue women cases in court for the first time.

Saudi Arabia also introduced significant reforms in the manner by which foreigners residing in the Kingdom were to be treated with respect to their labour law and human rights in general. King Abdullah appointed a well-respected *Shoura* member Dr. Bandar Al Aiban to head the Saudi Human Rights Commission in the February 2009 cabinet reshuffle, with powers for this commission to have the right to access to prisons and detention centres at any time and submit reports to the Prime Minister (the King) without the need to obtain official permission. The Saudi move on these fronts concerning relations with its foreign workforce, which constitutes a significant portion of the private sector workforce, is a recognition of the importance of adhering to international law concerning the treatment of labour and was in line with the King's directives to open up Saudi society to tolerance and moderation through national and international dialogue.

## **National Economic Planning: The Framework**

According to observers, Saudi Arabia has some of the most sophisticated development planning processes of any nation in the developing world (Cordesman, 2003). The Saudi government utilizes the services of resident technical experts from the World Bank to advise on the development process.

It is often said that “the best government is the most invisible government.” This means that “best” governments are those that establish regulatory and legal frameworks and then allow the competitive pressure of free market forces to determine

the optimum allocation of resources needed by society. There are those who would argue that this is a utopian luxury that governments in the modern world aspire to, but few achieve in reality. The real world has witnessed a degree of planning and government control, ranging from central planning to what is termed mixed economies, where the government and private sector work together in partnership. Irrespective of which model of planning is adopted, the central goal seems to be the laying of a broad economic foundation for self-sustaining growth, with one or more key factors of production (land, labour, capital or managerial efficiency) creating the precondition for such growth (Rostow, 1960).

Saudi Arabia's economic development path has sometimes been characterized as one of the classical "rentier" economies (Chadhury, 1989, 1997, Auty, 2001). In this model, the government seeks to maximize its revenue from a natural resource – oil – and distribute the proceeds amongst various sections of the population. Some distinguish between a "rentier" economy and a re-distributive "welfare state", which derives its income through taxation and other means from one class of society and distributes it to other sections of society (Chadhury, 1989).

Since Saudi Arabia currently does not impose taxes on its citizens, although there has been some debate on introducing value-added taxation, the term "welfare state" is not technically correct for the Kingdom. The concept of "rentier economy" is a more accurate characterization of the early years of Saudi Arabia's economic development. According to some observers, an alliance developed between the State and certain business groups in the private sector that aimed to promote the national agenda at the expense of some excluded groups (Wilson, 2004, Champion, 2003).

During the early boom period of the Saudi economy in the 1970s and early 1980s, the large inflows of oil "rents" to the State created a momentum of its own, in which it seemed that the State's only function was that of a distributive agent and that the government sector became the exclusive motor of the economy (Chaudhry, 1997). The lack of administrative, educational, managerial and physical infrastructure led to absorptive capacity bottlenecks in those early boom days, with investment decisions being taken that had far-reaching consequences for the future (Mallakh and Mallakh, 1982).

The basic argument against "rentier economies" is that when a state's main source of private revenues is through government expenditures, the society thus supported does not instil a sense of initiative or entrepreneurship amongst its citizens. However, a state that is supported by society through one form of taxation or another will develop a more balanced relationship with its citizens, with both parties responding to the needs of the other (Ehteshami, 2003).

One further effect of the "rentier economy" was the emergence of powerful state bureaucracies which "orchestrated the States' development" (Ehteshami, 2003). The effect was to perpetuate the preference for government jobs in Saudi Arabia, which we shall examine in later chapters, at the expense of the private sector, since bureaucracy viewed the private sector in a subservient relationship instead of as a dominant force. This relationship between the government and private sector has affected the "institutional capacity to deliver" (Wilson, 2004). Surveys of attitudes of senior civil servants carried out in Saudi Arabia in the early 1980s showed deficiencies in

“psychological drive, flexibility, communication, client relations and impartiality” (Hegelan and Palmer, 1999). According to some observers, there is little evidence that much has changed since those early days (Wilson, 2004).

### *Strategic Choices*

In the early 1970s, the Saudi government along with its key planners and consultants grappled with strategic decisions on the direction the economy should be steered to. It was not an easy task, given the lack of planning experience, absence of data on the economy and raised expectations of Saudi nationals. Table 2.1 examines some of the strategic development options that were faced by Saudi planners and their potential positive and negative implications.

**Table 2.1** Saudi Arabia: economic development options

| Development option  | Positive factors   | Negative factors   |
|---|--|--|
| Large oil production  | <ul style="list-style-type: none"> <li>• Large foreign investments and surplus financial resources</li> <li>• Balance of payment surpluses</li> <li>• No incentive to fund crude oil substitutes</li> </ul>  | <ul style="list-style-type: none"> <li>• Economic dependency</li> <li>• International and domestic inflation</li> <li>• Rapid consumption of non-renewable national resources</li> <li>• Rentier economy</li> </ul>  |
| Oil production based on domestic needs                                      | <ul style="list-style-type: none"> <li>• Moderate investments abroad leading to paced development and equilibrium between domestic development needs and financial resources.</li> <li>• Large oil reserves for future generations</li> </ul>                                      | <ul style="list-style-type: none"> <li>• World oil shortages</li> <li>• High international inflation and world recession</li> <li>• Strong incentive to find crude oil substitute and suppliers</li> </ul>   |
| Large-scale domestic industrialization and diversification of economic base | <ul style="list-style-type: none"> <li>• Potential economic independence</li> <li>• Skills acquisition and new working habits</li> <li>• Exports potential</li> <li>• Technology transfer</li> <li>• Education base widened</li> <li>• Non-oil economic diversification</li> </ul> | <ul style="list-style-type: none"> <li>• Large imports</li> <li>• Need for expatriate labour increased</li> <li>• Balance of payments problems with a large element of exported salaries and profits</li> <li>• Domestic inflation</li> <li>• Institutionalized inefficiency due to subsidy policy (import substitution industry)</li> <li>• Mismatch between domestic labour supply output and market requirements</li> </ul> |

Each of the options set out in Table 2.1 has appealing positive factors, and these positive factors would have been paramount in the planning discussions – rather than the negative consequences. The country was in a rush to develop rapidly. There were few lengthy discussions or in-depth analyses of potential negative consequences of one strategic development objective or another (Farsi, 1982), although some commentators did raise early concerns (Bashir, 1977).

From all indications, what has actually transpired from the early 1970s to date is that Saudi Arabia opted for large-scale domestic industrialization and for diversification of the national economic base. The aim was to “transform the economy from overwhelming dependence on the export of crude oil into a diversified industrial economy,” while admitting that dependence on oil revenues will continue for a considerable period of time (Farsi, 1982).

Depending on substantial crude oil production alone was not a long-term strategic choice, for it would have magnified the negative consequences of the “rentier economy” system discussed earlier. It would have meant a more rapid consumption of Saudi Arabia’s major non-renewable natural resource; the only key decision facing the country would simply have been the rate of oil extraction and the price of oil.

Production of oil based merely on Saudi Arabia’s domestic needs would have produced oil shortages, international inflation and world recession, along with a strong incentive to find other suppliers as well as crude oil substitutes. As we will explain in later chapters, Saudi Arabia is cognizant of its key role in world oil supply and has pursued moderating policies in its attempt to ease oil supply shortages. The most recent example was the Kingdom’s decision in June 2008 to increase its production from 8.3 million barrels to over 9 million barrels per day in order to ease soaring prices of over \$140 a barrel.

Adopting the large-scale industrialization and diversification option seemed then, on the surface, to have been the most viable option, with significant discernible advantages. The negative factors that have crept into this strategy over time are now causing the most concern. As will be discussed later, issues of mismatch between domestic labour supply and market needs, the continuing strain on balance of payments due to large expatriate labour remittances, institutionalized inefficiencies and, despite diversification, continuing reliance on oil and oil derivative exports are features of the Saudi economy today. Most of these problems are inherited from the earlier development plans.

## **The History of Saudi Planning**

Saudi Arabia has undergone a substantial and fundamental transformation over the past three decades since planning was first introduced in 1970. Those who were involved in the First Plan admitted that, in essence, the First Plan of 1970–1974 was essentially “an exploration, theoretical and empirical,” and that the biggest achievement was “the experience gained by Saudis in the field of development planning” (Farsi, 1982). Others are more critical of the whole planning exercise, arguing that



the development plans demonstrated good intentions, but did not pave the road to major progress (Cordesman, 2003).

There are those who argue that Saudi Arabian planning has been more “a macroeconomic exercise than a form of detailed microeconomic management” (Wilson, 2004). The argument is that Saudi planning involves designing public expenditure programmes in the light of anticipated revenues and then executing these expenditures. If revenues are actually achieved, then all is well: projects are implemented and delayed projects restarted. Conversely, if anticipated revenues do not materialize, then the opposite happens: ongoing projects are delayed and new ones suspended.

Planning, however, can be carried out under various models and circumstances, ranging from setting targets for the economy as a whole and providing direction on how resources will be invested, to establishing targets for input resources and the desired output. The Saudi model has not established precise *qualitative* output targets but rather *quantitative* output targets. Planning can also follow an indicative direction on how and where the government wishes the economy to go, providing the necessary rules and regulations to allow the private sector to achieve those directions (Osama, 1987).

Planning exercises do not operate in a vacuum and it is important to analyse the administrative structure under which Saudi planning is carried out. The first planning exercises, in the late 1950s and early 1960s, depended heavily on external bodies and consultants such as the Ford Foundation, the United Nations Team for Social and Economic Planning and the World Bank. In 1961 a Planning Board was established in Saudi Arabia and in 1965 it was incorporated into the Central Planning Organization (CPO), which drafted the Kingdom’s First Five-Year Plan in 1969.

In 1975 the CPO became the Ministry of Planning (MOP), reflecting the importance national planning was being assigned, although some argue that the Ministry of Planning in effect took a back seat to the actual implementation policies undertaken by the more powerful spending ministries such as Commerce, Industry and Electricity (Wilson, 2004).

Economic and social development in the Kingdom has been guided since 1970 by comprehensive five-year national development plans. As the economy expanded and grew more complex and diversified, the planning and fiscal management processes became ever more demanding and called for more sophisticated policy instruments, strong analytical capacities and diverse approaches to problem-solving and resolution. Furthermore, as the role of the private sector in the overall economy grew in size and importance, the planning process tracked this evolution by changing the planning paradigm from the *directive* to the *indicative*. This movement is expected to continue in the future as the government goes forward with its privatization programme and its role focused on providing the appropriate institutional, legal and regulatory environment most conducive to social and economic development, and for protecting the economically and socially disadvantaged.

To reinforce the importance of involving Saudi Arabia’s key decision-makers in the planning and implementation process, the Supreme Economic Council (SEC)



was established in August 1999. In November 2009 the SEC was reshuffled by King Abdullah, inducting Foreign Minister Saud Al Faisal and Prince Mohammed bin Naif, Assistant Interior Minister for Security Affairs, to this apex Saudi policy-making board, which has been dubbed a “mini-cabinet” by many. The 12-member panel includes the Ministers of Commerce and Industry, Economy and Planning, Water and Electricity, Labour, Petroleum and Minerals Resources and Finance. The SEC has taken a leading role in setting up specialized committees to discuss issues such as privatization, international relations and domestic security implications as signified by the new SEC-inducted members.

### ***Plan Achievements***

Actual and planned expenditures made by the Saudi government over the whole planning period from 1970 to date have been impressive, standing at around SR 3,135 billion or \$836 billion. This is set out in more detail in Table 2.2 for each planning period, organized by broad expenditure categories.

From Table 2.2, it becomes evident how closely government expenditure patterns follow the fortunes of the Kingdom’s oil revenues, with the current Eighth Development Plan (2005–2009) surpassing the peak “boom years” of the Third Development Plan period (1980–1984).

The expenditure trends of the Saudi development plans over time have become more evident: a focus on human resources development and education which accounted for 57.1% of the actual expenditures of the Seventh Development Plan (2000–2004) and reached 55.6% in the latest Eighth Development Plan (2005–2009). The Kingdom has recognized the fundamental importance of human development to the realization of sustainable economic and social goals. The Kingdom provides free education in its public schools, colleges and universities and, from the Seventh Development Plan, has made primary and secondary education compulsory with the aim of achieving universal primary education by 2015. According to the World Bank, adult literacy stood at 79% in 1999 and 88% in 2008. Another large sectoral expenditure item has been social and health development.

Social welfare and solidarity have been among the pillars of the development strategy of the Kingdom of Saudi Arabia. This important objective is pursued by ensuring that all citizens share the fruits of economic development across the various segments of society in all regions. Provision of public services and basic commodities at affordable prices has been one of the main components of this strategy. Furthermore, for segments of society at risk of being left behind or handicapped to equitably share the fruits of development, publicly and privately run programmes are in place to offer them the necessary help and assistance. Families and individuals in distress are assisted through a number of programmes conducted by the Deputy Minister of Social Affairs of the Ministry of Labour and Social Affairs.

Table 2.2 Expenditures during the Saudi development plans

| Expenditures                                 | Economic resources development |      | Human resources development |      | Social and health development |      | Infrastructure development |       | Total      |     |
|--|--------------------------------|------|-----------------------------|------|-------------------------------|------|----------------------------|-------|------------|-----|
|  | SR Billion                     | (%)  | SR Billion                  | (%)  | SR Billion                    | (%)  | SR Billion                 | (%)   | SR Billion | (%) |
| First Development Plan: 1970–1974 (Actual)   | 9.5                            | 27.7 | 7.0                         | 20.6 | 3.5                           | 10.3 | 14.1                       | 34.1  | 34.1       | 100 |
| Second Development Plan: 1975–1979 (Actual)  | 97.3                           | 28.0 | 51.0                        | 14.7 | 27.6                          | 8.0  | 171.3                      | 347.2 | 347.2      | 100 |
| Third Development Plan: 1980–1984 (Actual)   | 192.2                          | 30.7 | 115.0                       | 18.4 | 61.2                          | 9.8  | 256.8                      | 635.2 | 635.2      | 100 |
| Fourth Development Plan: 1980–1989 (Actual)  | 71.2                           | 20.4 | 115.1                       | 33.0 | 61.9                          | 17.7 | 100.7                      | 348.9 | 348.9      | 100 |
| Fifth Development Plan: 1990–1994 (Actual)   | 34.1                           | 10.0 | 164.6                       | 48.0 | 68.0                          | 20.0 | 74.2                       | 340.9 | 340.9      | 100 |
| Sixth Development Plan: 1995–1999 (Actual)   | 48.2                           | 11.5 | 216.6                       | 51.5 | 87.5                          | 20.8 | 68.1                       | 420.4 | 420.4      | 100 |
| Seventh Development Plan: 2000–2004 (Actual) | 54.4                           | 11.2 | 276.9                       | 57.1 | 92.6                          | 19.1 | 61.4                       | 12.6  | 485.3      | 100 |
| Eighth Development Plan: 2005–2009 (Actual)  | 105.8                          | 12.2 | 479.9                       | 55.6 | 155.7                         | 18.0 | 122.3                      | 14.2  | 863.7      | 100 |
| Ninth Development Plan: 2010–2014            | 227.6                          | 15.7 | 731.5                       | 50.7 | 273.9                         | 18.9 | 211.6                      | 14.7  | 1444.6     | 100 |

Source: Saudi Ministry of Planning, September, 2002, 2005, 2010

An important factor that contributes to a low incidence of extreme poverty in Saudi Arabia is one that is rooted in the culture and social traditions of the country. Strong family solidarity which permeates not only the nuclear family but also the larger and more extended family relations stretching as far as tribal boundaries in the rural areas helps protect those segments most at risk of poverty and need: the elderly, the orphaned and the young. Estimates of national poverty levels do not yet exist for lack of up-to-date survey data. No urban, rural or national poverty lines have yet been estimated.

It is important to analyse the different emphases placed during each planning period, reflecting national priorities. This is set out in Table 2.3, which captures key “planning indicators” for each plan, including the most recent Ninth Development Plan (2010–2014). It demonstrates that the planning focus has shifted towards allocative efficiency, human skill upgrading and private sector participation in economic diversification. The principal underlying themes of all plans continue to emphasize raising the standard of living of the people, improving the general quality of life and enhancing their skill capabilities. The Eighth Development Plan constituted a new methodological departure for Saudi Arabia, as it defined more precise targets quantitatively wherever possible and set out implementation schedules and assigned responsibilities for implementation agencies.

The Kingdom, in its Eighth and Ninth Five-Year Plans, has adopted strategic planning to complement the medium-term planning system and the shorter fiscal management process. This development has been motivated by the need to properly address some vital national issues that are characteristically of long-term nature such as resource development and utilization. Issues such as economic restructuring, human resource development, technology development (R&D), water and land management in a semi-arid environment and optimal utilization of the oil and gas resources, among others, all require long-term analysis and perspective.

As Table 2.3 indicates, one of the primary objectives over the last three plans has been an urgent insistence that the private sector play a greater role in the diversification of the economy. Saudi Arabia has realized that having rich natural resource endowments does not necessarily bring about sustained economic growth. In fact, other oil rich economies, such as Venezuela and Nigeria, experienced negative rates of per capita income growth between 1965 and 1996 (Gelb et al., 1998, Askari et al., 1997).

The importance of safeguarding Islamic values, cultural heritage and traditions continues to be emphasized at the outset of each plan. The intention was to promote economic development, but not “Westernization” – something which other traditional societies undergoing rapid development have found difficult to avoid. The Internet revolution makes maintaining a social *status quo* even harder, and Saudi society is no exception (Yamani, 1998, 2000, Rasheed, 2002). The recent advances made by Internet and global communication have broken down barriers; the IT revolution is one that few Saudi planners can ignore in the future. The impact of this flow of information has been researched in other Arab societies with social customs and traditions similar to that of Saudi Arabia; IT access has had a profound societal shaping effect (Masmoudi, 1998, Azzam, 2002).

Table 2.3 Saudi Arabia's national five-year development plans: key indicators

| Overall national priorities   | First (1970–1979)   | Third (1980–1984))  | Fourth (1985–1989)   | Sixth (1995–1999)  | Seventh (2000–2004)  | Eighth (2005–2009)  | Ninth (2010–2014)  |
|---|---|---|--|--|--|---|--|
| <ul style="list-style-type: none"> <li>• Safeguard Islamic values in conformity with <i>Shariah</i></li> <li>• Improve standard and quality of life</li> <li>• Develop human resources, increase productivity and replace non-Saudis with qualified Saudis</li> <li>• Realize balanced growth in all regions</li> <li>• Diversify economic base and reduce dependence on production and export of oil</li> <li>• Provide favourable environment for activities of the private sector to encourage it to play a leading role in development</li> </ul> | <ul style="list-style-type: none"> <li>• Focus on provision of modern infrastructure, basic government services</li> <li>• Expansion of human resources and beginning of infrastructure growth</li> <li>• Starting hydrocarbon industries</li> <li>• Establishment of modern administrative infrastructure</li> </ul> | <ul style="list-style-type: none"> <li>• Expanding Infrastructure, economic resources</li> <li>• Human resources and educational base expansion</li> <li>• Hydrocarbon base expansion</li> <li>• Undertaking regional economic initiatives</li> </ul> | <ul style="list-style-type: none"> <li>• Concentration on operation and maintenance</li> <li>• Reconstructing the economy to allow more private sector participation</li> <li>• Human Resources and health expenditure rose</li> <li>• Shift from central planning projects approach to programme planning approach</li> </ul> | <ul style="list-style-type: none"> <li>• Human resources emphasis as well as social and health</li> <li>• Aiming for balanced budget</li> <li>• Reduction in foreign labour</li> <li>• Private sector expansion</li> <li>• Beginning of partial privatization</li> <li>• Reduction of subsidies</li> </ul> | <ul style="list-style-type: none"> <li>• Solving human resource problems</li> <li>• Diversify the economy</li> <li>• Increasing gas production</li> <li>• Consolidating efficiency in production, refining and distribution</li> <li>• Reducing State budget deficit</li> <li>• Increasing privatization</li> <li>• <i>Saudization</i></li> <li>• Preparing for globalization, WTO</li> <li>• Privatization as strategic option</li> </ul> | <ul style="list-style-type: none"> <li>• Increase number of new entrants to labour market</li> <li>• Develop human resources and upgrade efficiency</li> <li>• Enhance national economic competitiveness and integrate into international economies</li> <li>• Enhance private sector cooperation</li> <li>• Continue institutional reforms</li> <li>• Develop science and technology system as base for economy</li> <li>• Reduce regional development disparities</li> <li>• Upgrade human capabilities and remove constraints that impede participation</li> </ul> | <ul style="list-style-type: none"> <li>• Raise standard of living of citizens</li> <li>• Diversify economic base</li> <li>• Move towards knowledge-based economy</li> <li>• Strengthen role of private and public sector</li> <li>• Continue institutional reforms</li> <li>• Develop SME sector</li> <li>• Bolstering human rights</li> <li>• Achieve balance regional development</li> <li>• Promote economic development with GCC and other powers</li> </ul> |

Source: Ministry of Planning

The Ninth Development Plan makes gender equality and women’s empowerment issues more explicit, and Saudi Arabia has gone a long way to completely eliminate gender disparity at all levels of education. Expansion of female education has encouraged many Saudi females to join the labour force and seek employment and try to move away from the traditional sectors of education, health and social services. Expenditures during the latest Ninth Plan for the period 2010–2014 are forecasted at a record SR 1444 billion, more than the combined previous three plans, with around 50% allocated for human resources development.

## The Performance of the Saudi Economy

Saudi Arabia’s GDP is still dwarfed by the leading industrialized countries, as illustrated in Fig. 2.1. The GDP figures for the various countries do not necessarily reflect the quality of life in each country, as only “economic” factors are included in GDP estimates, despite recent attempts to include qualitative measures. What Fig. 2.1 illustrates is that, despite massive government spending over the past three decades, the Saudi economy seems insignificant compared to the world’s giants, such as the USA or Japan, and is in fact smaller than medium-sized industrialized countries such as Belgium or Switzerland.

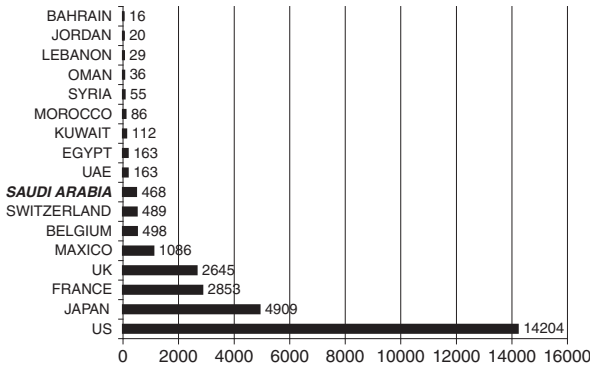


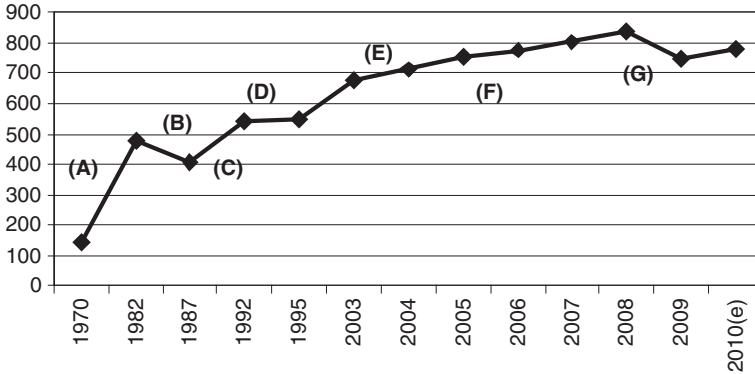
Fig. 2.1 2008 GDP comparison (US \$ billions) (Source: World Bank, 2010)

It is sometimes noted that a GDP the size of the Saudi economy is added to that of the USA every 7–8 months when the U.S. economy grows at a real rate of 3% p.a. The basic reason for the lag in Saudi GDP growth is simple: the U.S. economy is diversified while Saudi Arabia’s is not.

All of Saudi Arabia’s economic reform efforts and development plans to date centre around the fact that its economy is essentially oil-driven, with the resultant strengths and weaknesses. The performance of the Saudi economy has been heavily influenced by two major factors: first the level and growth of oil revenues and second the government budgetary policies. The latter function as the main link between the

oil sector and the rest of the economy on one side, and economic growth in case of reduced or increased oil revenue on the other.

The result has been identifiable major Saudi business cycles, each with its own characteristic, as illustrated in Fig. 2.2.



**Fig. 2.2** Saudi Arabia: major business cycles GDP 1970–2010 (SR billions at constant prices (1999 = 100) (Source: SAMA, 2009, Estimate 2010)

From Fig. 2.2 the following major business cycles are identified:

- A. An oil boom cycle from 1970 to 1982
- B. An oil bust cycle from 1983 to 1987
- C. A recovery cycle from 1988 to 1992
- D. A stagnation cycle from 1993 to 1995
- E. A restructuring cycle from 1996 to 2002
- F. An oil boom cycle from 2003 to 2008
- G. A retrenchment cycle from 2009

Figure 2.2 indicates several distinct business cycles from 1970 to 2009. The first cycle was characterized by high oil prices, rapid economic growth, elevated government expenditure on infrastructure, high per capita income and private sector demand. The second cycle – the oil bust era – saw the Saudi economy take a dramatic downturn. Crude oil production declined from an average of 9.81 million barrels per day in 1981/1982 to an average of 3.2 million barrels in 1985. Oil prices dropped from peaks of \$34 a barrel in 1981 to \$11.5 a barrel in 1986. Government revenues fell drastically to around SR 50 billion in 1986 compared to nearly SR 400 billion in 1981. As a result, imports fell and there was a reduction in investment expenditure by both the government and private sectors. The third phase – or recovery business cycle – showed a reversal of fortunes due to improvement in world oil markets, but was followed by a relatively stagnant business cycle affected by declining oil prices and fiscal constraints.

The period between 1992 and 1995 was characterized by budget cuts across the board, a freeze on capital expenditure and a slowdown in government cash disbursements, which caused some problems to private contractors. From the oil bust cycle, the Saudi government started to draw down on its overseas liquid reserves, resulting in growing budget deficits and debt service payments, as shall be explored in more depth in later chapters.

The fifth cycle from 1996 to 2002 was a critical one, in which economic reforms and major restructuring efforts took place, with the government trying to ensure that the private sector becomes the main engine of growth. This cycle saw progress in the field of privatization, liberalization and capital market reforms, in order to attract FDI and Saudi capital held abroad.

The period from 2003 to 2008 was the second longest economic boom period in Saudi Arabia with real GDP growth increasing by an average of 5% a year, the strongest for a decade. Record oil prices and abundant liquidity characterized the period, with oil prices reaching \$147 pb in mid-2008, but falling back to an average of \$55–60 pb in 2009 and an average of \$68–75 pb in 2010. The current cycle from 2009 can be viewed as another period of retrenchment and restructuring for the Saudi economy, which also witnessed the unfolding global financial and credit crisis. Although the Kingdom has been less affected by the direct impact of the global financial crisis of 2008/2009 and economic recession, the indirect impact affected the real economy through reducing government revenues, tighter credit and investor risk aversion in international markets to the Gulf region, leading to reduction of foreign capital and decline in local asset prices.

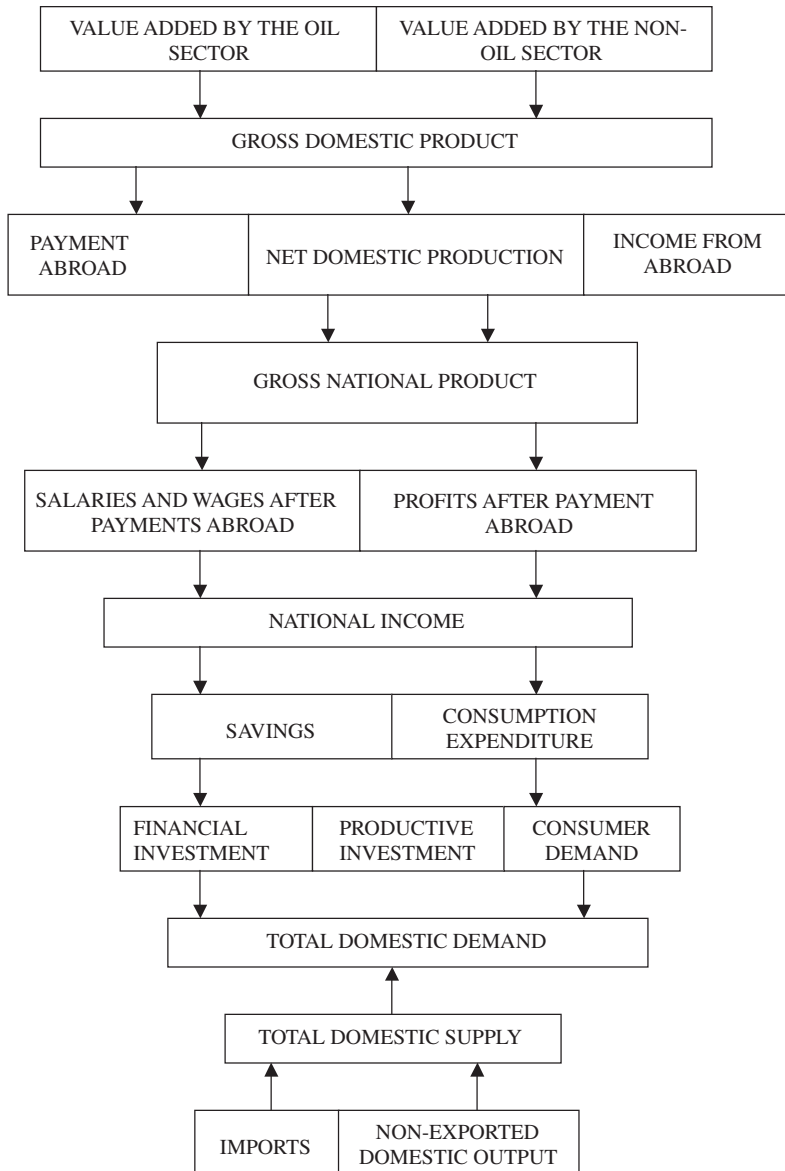
## **Economic Diversification: Realities**

In order to assess the effectiveness of the Saudi economic diversification effort, we must analyse more closely the Saudi national accounts, which provide an insight into the structure of the nation's economy. An examination of these accounts helps one to decide whether the Saudi economy has unique characteristics compared to other economies.

The GDP is the sum of the value added by the various sectors of the economy – in other words, the market value of the total output of goods and services produced during a year. The Gross National Product (GNP) includes both the results of domestic activity within Saudi Arabia and the results of its economic relationship with the rest of the world. For Saudi Arabia, the government and the foreign sector play important roles as seen in Fig. 2.3.

Figure 2.3 highlights three important features of the Saudi Arabian economy. First, as the earlier analysis of the different business cycles showed, the model underlines the crucial role played by the government sector. The importance of oil and oil revenues ensures that the government, through its fiscal budgetary mechanism, is still in a position to influence both the level and structure of economic activity. These can be transmitted through direct expenditure on consumption and investment, as well as provision of “soft” long-term loans and subsidies.





**Fig. 2.3** Saudi Arabian model of economic flows (Source: Adapted from Cleron, 1978, p. 74)

The second feature of the Saudi model is the degree of interdependence with the rest of the world. This has risen dramatically as oil income has increased, with oil exports representing some 54% of GDP in 1979/1980, falling back to 40% levels in 1999/2000 and rising again to 60% levels in 2008. Imports from the rest of the world represented 55% of GDP in 1979/1980 and 12% in 2008 (SAMA, 2009).

The third striking element is the relatively large portion of the GDP that is paid for the use of foreign-owned resources – namely foreign labour working in the Kingdom as well as foreign-owned oil-related activities. As we will examine later, the campaign to reduce the number of outside workers and the dependency on foreign labour and to replace them with Saudi nationals – the so-called *Saudization* effort – has been partially successful. The size of remittances sent abroad by foreign labour continues to be a significant outflow as illustrated in Table 2.4.

**Table 2.4** Remittances from Saudi Arabia (SR billion)

| Year              | GDP at constant prices (1999 = 100) | Private transfers |
|-------------------|-------------------------------------|-------------------|
| 1970              | 148.0                               | 0.81              |
| 1976              | 416.5                               | 3.5               |
| 1982              | 480.5                               | 18.0              |
| 1993              | 552.7                               | 58.8              |
| 1995              | 557.6                               | 62.2              |
| 1998              | 608.1                               | 56.0              |
| 2000              | 632.9                               | 57.7              |
| 2001              | 641.2                               | 56.9              |
| 2002              | 647.7                               | 59.4              |
| 2003              | 686.0                               | 55.4              |
| 2004              | 722.2                               | 50.8              |
| 2005              | 762.3                               | 52.4              |
| 2006              | 786.3                               | 58.5              |
| 2007              | 812.4                               | 60.2              |
| 2008 <sup>a</sup> | 848.5                               | 79.5              |

<sup>a</sup>Provisional

Source: SAMA, 2009

According to SAMA, the total amount of private remittances and transfers sent from Saudi Arabia for the period 1970–2008 amounted to a staggering SR 1,229 billion (\$327 billion). Such figures prompt, from time to time, heated debates in the local media about the need to speed up the *Saudization* process or to impose curbs on remittances. Others argue that one way to reduce outflows would be to introduce a more investor-friendly climate in Saudi Arabia so that foreign workers can invest locally.

Comparisons are sometimes made with the United States, which has the world's largest immigrant population and yet records lower remittance outflows on a per capita basis compared to Saudi Arabia because of more favourable domestic investment opportunities for U.S. migrant labour. Whatever the arguments, the current level of remittances – amounting to around 10% of GDP and around 18% of private sector GDP – will continue to cause a serious balance of payment problem for Saudi Arabia in the foreseeable future.

### Composition of Saudi GDP

The next set of figures and tables sets out in more detail the composition of Saudi GDP, from the pre-oil boom period to the “restructuring” era. It provides a closer examination of the “realities” of economic diversification and how far the private sector has taken over from the government in the key areas of consumption expenditure, investment and exports.

Figure 2.4 illustrates the historical GDP growth of the Kingdom from around \$150 billion in 1980/1981 to around \$300 billion in 2009.

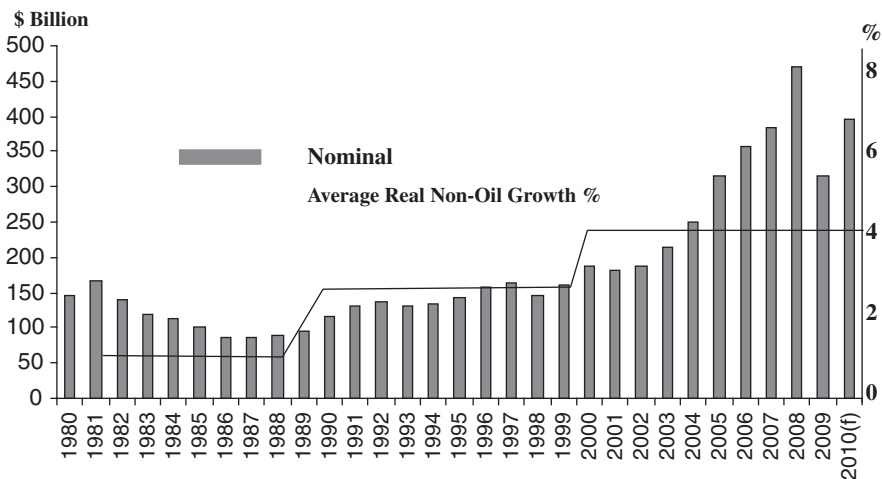


Fig. 2.4 Historical GDP Growth Developments (Source: SAMA, IMF, estimates)

The non-oil sector has been making steady progress and its contribution has been less erratic than the oil sector as Fig. 2.5 illustrates, although the non-oil private sector was also affected by the sharp fall in oil prices and reduction in crude oil production in 2009 as illustrated in Fig. 2.6.

A closer breakdown of the GDP by economic activity reveals the gradual rising value of manufacturing and the services sector in the Saudi economy since the modern economy started to take shape. This is illustrated in Table 2.5.

As a percentage share of the Saudi GDP, however, manufacturing continues to hover at around 10%, with petroleum refining and petrochemicals representing almost half of the manufacturing contribution to GDP. The service sector accounts for less than 30% of the GDP, with finance, insurance and real estate expanding their share, as well as the general trading sector. Construction activity seems to be affected by general business cycle movements but is still an important segment of the economy at around 8% of GDP. Agriculture, despite massive subsidy support in the early boom period, accounts for around 5% of the GDP, with Saudi Arabia a net importer of food products.

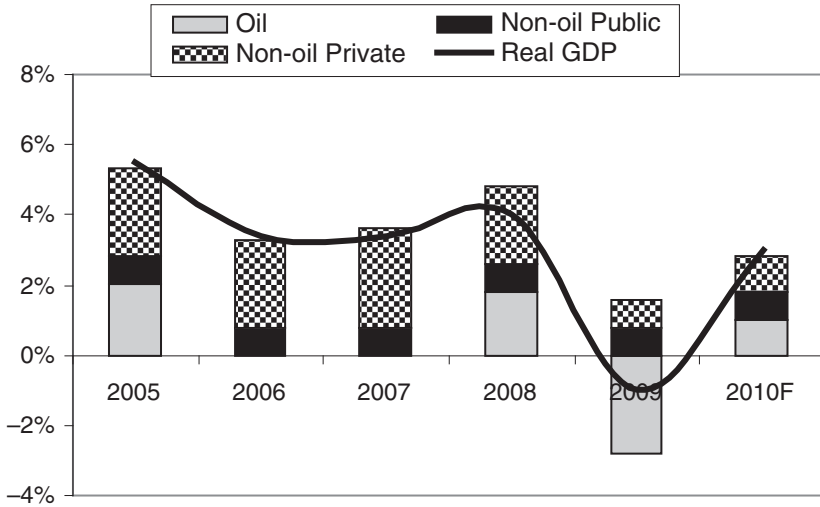


Fig. 2.5 Real GDP growth sector contribution (2005–2010) (Source: SAMA, forecast)

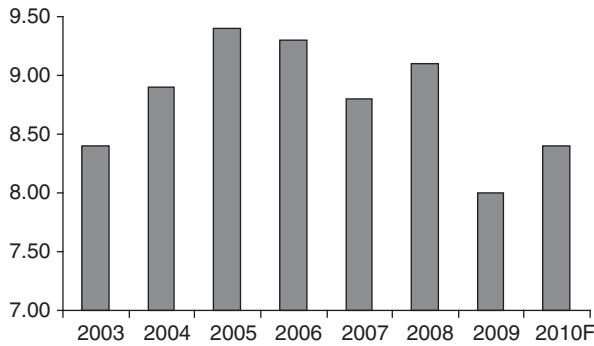


Fig. 2.6 Average Saudi crude oil production: 2003–2010 (Million barrels per day) (Source: OPEC, SAMA)

The data in Table 2.5 reflect the growing importance of wholesale, retail and restaurant activity. However, this activity consists largely of the marketing of imported goods and growth has been linked to Saudi demographic factors and changing consumer tastes and fashion. The community, social and personal services sectors, and the water and electricity sectors have also grown steadily, but have lagged behind population growth; however, the growth in the Saudi financial sector has been impressive and now accounts for around 13% of the GDP compared with 5–7% levels in earlier periods.

As will be analysed in later chapters, the accession of the Kingdom to the World Trade Organization and the liberalizing of FDI regulations has given the financial

**Table 2.5** GDP by sectors and types of economic activity in producer's values (SR million)

|  | 1969   | 1984    | 2000    | 2004    | 2009    |
|--|--------|---------|---------|---------|---------|
| <i>Non-oil sectors</i>   | 8,870  | 227,130 | 370,400 | 525,267 | 677,239 |
| Producing sectors  | 3,790  | 85,280  | 150,400 | 178,250 | 234,214 |
| Agriculture, forestry and fishing                                  | 990    | 11,620  | 35,570  | 38,005  | 44,399  |
| Non-oil mining   | 50     | 1,860   | 2,520   | 2,723   | 3,982   |
| <i>Manufacturing</i>   | 1,500  | 27,430  | 58,740  | 79,476  | 107,206 |
| Petroleum refining   | 1,090  | 13,830  | 21,590  | 20,508  | 25,443  |
| Petrochemicals   | N/A    | 540     | 7,080   | 7,352   | 10,446  |
| Other manufacturing  | 410    | 13,060  | 30,070  | 51,616  | 71,317  |
| Electricity, gas and water   | 260    | 590     | 970     | 11,085  | 13,589  |
| Construction   | 990    | 44,960  | 52,600  | 46,961  | 65,038  |
| <i>Service sectors</i>   | 5,080  | 141,850 | 220,000 | 211,953 | 280,133 |
| Trade hotels, etc.   | 990    | 30,390  | 39,250  | 57,299  | 73,980  |
| Transport, storage and communications                              | 1,230  | 23,850  | 34,780  | 36,674  | 52,727  |
| Finance, insurance, real estate and business services <sup>a</sup> | 950    | 25,830  | 24,060  | 90,724  | 121,103 |
| Community, social and personal service                             | 230    | 9,710   | 15,210  | 27,256  | 32,323  |
| Government services  | 1,680  | 52,070  | 106,700 | 135,064 | 162,892 |
| <i>Oil product sector</i>  |        |         |         |         |         |
| Crude oil and natural gas  | 7,740  | 120,300 | 269,320 | 196,696 | 225,049 |
| Gross domestic product in producer's values                        | 16,610 | 347,430 | 639,720 | 721,963 | 902,288 |
| Import duties  | 270    | 3,970   | 9,620   | 7,063   | 7,122   |
| <i>Gross domestic production in purchasers' values</i>             | 16,880 | 351,400 | 649,340 | 729,026 | 909,410 |

<sup>a</sup>Net of imputed bank services charges

Source: Ministry of Planning, 2004, SAMA, 2009

sector a boost, attracting foreign entry as well as added depth to existing market segments such as insurance.

The importance of these sectors contribution to the GDP is illustrated in Fig. 2.7, while Fig. 2.8 highlights GDP growth by expenditure.

On the expenditure side, investment and private consumption were the main sources of growth in recent years, which were supported by the range of economic reforms mentioned earlier in this chapter. Investment, both private and public, has steadily risen from around 20% levels of GDP in 2004/2005 to nearly 30% of GDP in 2008. Weaker oil prices in 2009 affected the level of both public and private investment to take it back to under 27%.

Saudi Arabian national income data are more difficult to obtain than GDP data. This is due to the high level of data aggregation. National data analysis will help explain who gets what of the national revenue. Intuition would suggest that the government obtains the major component of revenue through oil income. The rest is composed of profits made by business and wages and salaries as well as transfer payments for individuals.

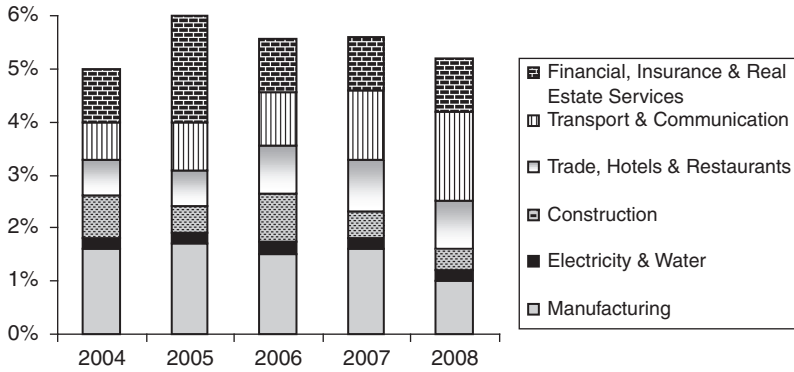


Fig. 2.7 Non-oil GDP growth and sector contribution (Source: SAMA)

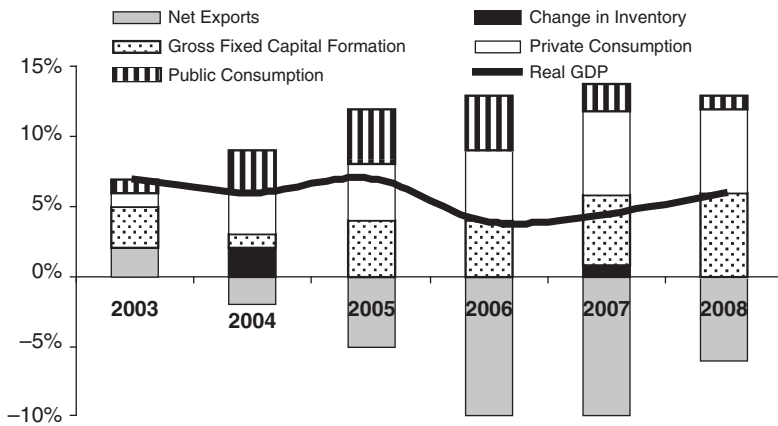
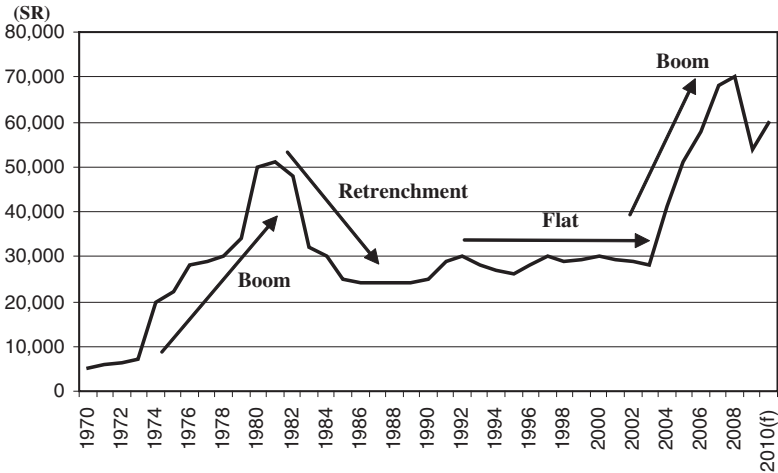


Fig. 2.8 Real GDP growth by expenditure (Source: SAMA).

In Saudi Arabia there is also a large element of “transfer payments” through the form of subsidies and subsidized products, especially agricultural products. Per capita income can, however, provide another proxy for how Saudi Arabian citizens have been doing over the past few decades, as per capita income, in which GDP is divided by population, is one measure of national income. Figure 2.9 illustrates GDP per capita over the period 1970–2009, and forecast for 2010.

The per capita income has mirrored the erratic oil revenue business cycles highlighted earlier in the chapter, to stand at roughly SR70,000 (\$19,000) in 2008 compared with SR 5,000 (\$1,500) levels in the pre-oil boom era of the early 1970s.

However, Saudi GDP per capita includes non-Saudis who, according to the latest data, accounted for 6.69 million or 27% of a total 2008 population of 24.81 million (SAMA, 2009, p. 298). If one takes into account inflation over the years since 1970, Saudi GDP per capita figures in *real terms* fell sharply to around SR 35,000 (\$9,300), using 1999 as a base year.



**Fig. 2.9** GDP per capita (current SR) (f = forecasted) (Source: SAMA, 2009)

In analysing Saudi Arabia's national income data, the distinction between "stock" and "flow" of income becomes important. Saudi Arabia has what seems to be a flow of income, although erratic, from oil and oil-based revenues, but seems to be "stock income poor" compared to other developed economies. It takes time to convert "income flows" into "stocks of wealth," which include infrastructure, capital goods, technical skills and "quality" education output (Chenery, 1979). Social awareness, work ethics and civic participation are also other "intangibles" of a nation's stock of wealth, which, if nurtured, could produce a more sustained growth take-off.

In later chapters, we will examine the effects of such tangible and intangible factors on Saudi Arabia's economic development prospects, especially on education and employment objectives. While Saudi Arabia has made progress in many areas, the measures the government seems to have taken so far have "lacked the scale and speed" needed to restructure the economy at the rate required (Cordesman, 2003).

Economic theory stipulates the importance of capital accumulation in economic development, with special emphasis on both "capital deepening" and "capital diffusion." The former requires additional input of capital, while the latter involves changes in technology (Bernstein, 1973, Thirwall, 1994, Todaro, 1994). The large oil revenue surpluses Saudi Arabia amassed during earlier boom years allowed it the luxury of investing and expanding its capital stock.

With the rush to modernize and spend the windfall gains, Saudi planners appear to have neglected to take the time to ask essential questions about such concerns as the optimum rates of investment in domestic capital formation (Karl, 1997, Looney, 1989, Askari, 1990). Should these investments have been in tangibles – or intangibles such as quality education – so that a knowledge-based economy built on capital diffusion would become the engine of growth? Given the luxury of earlier capital surpluses, Saudi Arabia could seemingly have chosen both options, as evidenced from the previous analysis of budgetary expenditures on human resource



development in the five-year plans. However, expenditures mask qualitative allocations and their economic effectiveness in the long run. The lack of disaggregated data on gross fixed capital formation (GFCF) makes it difficult to make a judgement, but as Table 2.6 highlights, the major element of GFCF has been in the construction sector. This is not surprising given the relatively young population of Saudi Arabia, but the expenditure on machinery and equipment has also been impressive as the Kingdom has built some large-scale hydrocarbon-based industries.

**Table 2.6** Gross domestic fixed capital formation by sectors and type of assets in purchasers values

|                                    | 1969  | 1974   | 2001    | 2005    | 2007    |
|------------------------------------|-------|--------|---------|---------|---------|
| (a) By sector (Million SR)         |       |        |         |         |         |
| <i>Oil sector</i>                  | 350   | 3,180  | 14,240  | 22,231  | 50,700  |
| <i>Non-oil sectors</i>             | 2,350 | 9,650  | 111,855 | 173,401 | 235,543 |
| Private                            | 1,000 | 4,300  | 94,347  | 118,461 | 140,304 |
| Government                         | 1,350 | 5,350  | 17,508  | 54,940  | 95,239  |
| <i>Total (GDFCF)</i>               | 2,700 | 12,830 | 126,095 | 195,632 | 286,243 |
| (b) By type of assets (Million SR) |       |        |         |         |         |
| <i>Construction</i>                | 2,100 | 9,520  | 57,909  | 93,620  | 138,627 |
| Residential buildings              | 610   | 2,320  | 28,302  | 31,973  | 37,823  |
| Non-residential                    | 1,490 | 7,200  | 29,607  | 61,647  | 100,804 |
| Transport equipment                | 290   | 1,470  | 21,004  | 28,804  | 35,168  |
| Machinery and equipment            | 310   | 1,840  | 37,472  | 55,922  | 87,504  |
| <i>Total (GDFCF)</i>               | 2,700 | 12,830 | 126,095 | 195,632 | 286,243 |

Source: SAMA, 2009

Oil sector GFCF has risen over the past few years to reach around 17–18%, but is still considerably below the 24% levels of the first Saudi oil boom infrastructure investment of 1974.

Given Saudi Arabian intentions to produce oil at an increased capacity to reach 11.5 mbpd as of 2011, as well as plans for expanding the gas sector, investment in these areas will have to involve either greater government expenditures or foreign investment to meet expansion plans. It is not a coincidence that Saudi Arabia has tried to attract international oil companies as partners and several large joint Saudi Aramco and foreign company projects were signed during 2008/2009.

The government data indicate *gross* investments and there are no reliable estimations as to actual *net* investments that the Kingdom is making after taking account of depreciation in the capital stock. The problem of depreciation accounting is well recognized in country GDP estimations, but it is also important to bear in mind that GFCF figures could provide an overly optimistic picture when the true net fixed capital formation figures are much lower. Given that the stock of Saudi capital formation is relatively new, having been built up over the period 1976–1986, the rate of depreciation might be lower compared to other countries. This, however, is offset by the relatively harsh environmental conditions under which Saudi projects operate, which could, in theory, accelerate both the rate of depreciation and replacement.

## The Challenges Ahead

While some significant economic achievements have been registered by the Kingdom over the past four decades, meeting the needs of a fast-growing and young population with high expectations poses several challenges to the development process. The planning process that might have served Saudi Arabia in the past needs to be revisited. A more strategic and flexible short-term planning process is probably more suitable in a global economy that is evolving faster. It is worth highlighting that there has been some flexibility in this regard with the Eighth Five-Year Plan, which adopts strategic planning to complement medium-term planning, as well as shorter-term fiscal planning. Most observers of the Saudi economy agree that economic, social and structural reforms are now a necessity and not a luxury (Najem and Hetherington, 2003, Wilson, 2004, Champion 2003).

However, there are differences of opinion about the pace and scale of reform, as there are many different estimates of trends in the Saudi economy and how these interact with the most pressing issues of the moment, such as population and unemployment levels. In addition, these different estimations disagree about the level of problems that Saudi Arabia will face in the future. Added to this is a debate on the effectiveness of the economic assumptions of “Western” modernization theories that do not take into account non-Western cultures and customs (Najem and Hetherington, 2003, Abdeen and Shook, 1984). Saudi Arabia has made it clear that reforms will come at a pace that is driven by Saudi domestic considerations and this has been the hallmark of the reforms introduced by King Abdullah.

Table 2.7 explores some key conditions for Saudi economic growth and whether these conditions are of increased, decreased or neutral importance.

In the end, there can be no certainties in forecasting data for any country – developed or developing – regardless of the quality of data. Saudi Arabia is a case in point: observers of the economy seem to be either overly optimistic or overly pessimistic about the future, depending on the basic assumptions and trends one picks. The truth of the matter is that the Saudi economy lies somewhere in between, despite considerable “developed” country characteristics, which includes overdependence of the GDP and budget on petroleum revenues, lack of economic diversification and a high level of bureaucracy. However, some trends have emerged over the past few years that show Saudi Arabia can still effect meaningful change.

Table 2.7 sets out some necessary preconditions for growth that are sometimes used to assess a country’s stage of development. Some of these factors are not based on hard data sources, but instead rely on perceptions. The table includes eight factors that assist growth without necessarily actively promoting growth (The Arab World Competitiveness Report, 2002–2003, p. 12). Poor performance would limit growth. From the table, we note that the Kingdom has preserved an open, international trading system, and is beginning to develop a more sophisticated financial system that is fairly solvent. In some areas the economy might seem to be under stress, such as inflation worries, but overall it is not one that is in crisis. Development of laws in support of a “new” economy is high, but the quality of government services as

**Table 2.7** Saudi Arabia: necessary conditions for growth

| Factor   | Component | Saudi Arabian setting |
|--|-----------|-----------------------|
| <i>Necessary conditions for growth</i>                           |           |                       |
| ● Macroeconomic stability  |           |                       |
| – Government deficits  |           | ↓                     |
| – Inflation  |           | ↑                     |
| – Exchange rate stability  |           | →                     |
| – Solvency of financial system                                   |           | ↑                     |
| ● Deep financial markets   |           |                       |
| – Interest rate spreads  |           | →                     |
| – Developed equity markets                                       |           | ↑                     |
| – Sophistication of financial system                             |           | ↑                     |
| ● Openness to international trade                                |           |                       |
| – Low import tariffs   |           | →                     |
| – Low hidden import barriers                                     |           | ↓                     |
| ● Quality of government  |           |                       |
| – Public expenditure not wasteful                                |           | ↑                     |
| – Subsidies improve productivity                                 |           | ↑                     |
| – Senior management spend little time with government officials  |           | ↑                     |
| – Admin. regulations burdensome                                  |           | ↑                     |
| ● Infrastructure   |           |                       |
| – Road quality   |           | ↑                     |
| – Efficient electrical generation                                |           | ↑                     |
| – High level of competition in provision of basic infrastructure |           | ↑                     |
| ● Education  |           |                       |
| – Years of schooling in population                               |           | ↑                     |
| – Perceived quality of education                                 |           | ↑                     |
| – Companies invest in training                                   |           | ↑                     |
| ● Rule of law  |           |                       |
| – Independent judiciary  |           | ↑                     |
| – Ability to successfully litigate against government            |           | →                     |
| ● New economy  |           |                       |
| – Internet hosts   |           | ↑                     |
| – Computers per capita   |           | ↑                     |
| – Development of laws in support of new economy                  |           | ↑                     |

Note: ↑ refers to high importance, ↓ refers to low importance, → refers to neutral

Source: Adapted from the Arab World Competitiveness Report 2002–2003. pp. 10–11

they relate to interaction with the general public needs to be improved, as does the perceived quality of education.

“Engines of growth” are essential to start a virtuous cycle of economic growth. Table 2.8 includes the more dynamic factors that focus on these conditions for Saudi Arabia.

The lack of export diversification, a culture innovation and research and development is the key impediment to kick-starting some engines of growth.

Administrative barriers to start-ups are high despite loan availability and a non-existent taxation regime for Saudi individuals and corporations. The latter pay a

**Table 2.8** Saudi Arabia: Engines of growth, current status

| Factor  | Component | Saudi Arabian setting |
|---|-----------|-----------------------|
| <i>Engines of growth</i>                                  |           |                       |
| ● Start-ups and entrepreneurship                          |           |                       |
| – Administrative barriers to start-ups                    |           | ↑                     |
| – Venture capital availability                            |           | ↓                     |
| – Loans available with low collateral                     |           | ↓                     |
| ● Capital accumulation                                    |           |                       |
| – National savings rate                                   |           | ↑                     |
| – Investment rate   |           | →                     |
| (Gross Fixed Capital Formation)                           |           |                       |
| ● Taxation  |           |                       |
| – Income tax rate   |           | N/A                   |
| – Corporate tax rate (foreigners only)                    |           | ↓                     |
| – Value-added taxes                                       |           | N/A                   |
| – Tax system perceived to improve competitiveness         |           | N/A                   |
| ● Innovation  |           |                       |
| – Highly rated research institute                         |           | ↓                     |
| – Business conducts R&D                                   |           | ↓                     |
| – Close collaboration between universities and businesses |           | ↓                     |
| – Government supports research                            |           | ↑                     |
| – High expenditure on R&D                                 |           | ↓                     |
| ● Transfer of technology                                  |           |                       |
| – Foreign direct investment brings new technology         |           | ↑                     |
| – Licensing pursued to obtain foreign technology          |           | ↑                     |
| ● Export diversification                                  |           |                       |
| – Exports other than national resources                   |           | ↓                     |

Note: ↑ refers to high importance, ↓ refers to low importance, → refers to neutral

Source: Adapted from Arab World Competitiveness Report 2002–2003

2.5% *zakat* or religiously ordained levy on total assets, while foreign company corporate taxes were reduced to 20% in 2003. As discussed earlier, GFCF is still low despite a fairly high national savings rate, while non-oil-related export diversification has not matched national expectations.

## Conclusion

As we will examine in later chapters, long-awaited structural changes and diversification efforts have not generated the necessary private sector jobs or produced a sustained “knowledge-based” economy. Expansion has been largely in the non-manufacturing services and construction sectors. The Saudi government has, to its credit, recognized a lot of these problems and is seeking ways to overcome them. The planning process has helped to identify key national objectives, but the emphasis going forward must be on *qualitative* rather than *quantitative* outputs.

The Saudi government, above all, must not waver in carrying through the necessary, harsh adjustments and reforms irrespective of temporary oil-related windfalls such as those that occurred during the period 2007–2008. Promised reforms in past Saudi development plans have been delayed or not fully implemented, particularly at times when the economy seemed to benefit from periods of relatively high world oil prices. It thus becomes easy to delay the economic and social costs of reforms when “windfall” government revenues are available; it takes long-sighted political skill and courage to continue with essential reforms, despite the temptation to ease back. The recent reform initiatives of King Abdullah on several key fronts are cognizant of time constraints and the need to act more quickly and decisively.

## Summary of Key Points

- *Saudi Arabia has embarked under a more invigorated series of economic, social and political reforms since the accession of King Abdullah bin Abdulaziz as King in 2005, which is shaping the future direction of the Saudi economy.*
- *Saudi Arabia has put in place a system of sophisticated development planning since 1970 through implementing a series of medium-term five-year plans.*
- *The process of planning has evolved as the economic structure of the country has undergone transformation with the private sector assuming more importance in both consumption expenditure and GFCF.*
- *The strategic choices that early planners made to steer the economy from overwhelming dependence on oil are still being felt today in the area of continued foreign labour dependence, outward remittances and mismatch between domestic labour supply and market requirements.*
- *Planning is now shifting from a “directive” to an “indicative” role as the economy becomes more globalized and interdependent with the rest of the world.*
- *Precondition for growth as well as key “engines of growth” are examined as well as the obstacles that need to be overcome to support the emergence of a private sector-led economy.*



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