

# Saudi Arabia's Economic Development: Ambitious Visions, Difficult Dilemmas

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**Abstract:** The sharp rise in oil price is bringing a huge increase in the resources which the government of Saudi Arabia can spend on development. The government has responded by creating highly ambitious new development plans, with a vision of turning the country into a global industrial power by 2024. This article looks first at the historical record of oil booms in Saudi Arabia, focusing in particular on what happened in the first oil boom (1973-82). While the latter boom did see substantial development in specified fields, it failed to lead on to sustainable non-oil development. The article contends that there is reason to believe that the new developmental vision is well-grounded in reality. This is mainly because Saudi Arabia's accession to the WTO will give Saudi petrochemicals better access to world markets. Due to the character of the labor market, however, Saudi Arabia's emergence as a global industrial power (based on petrochemicals) will not resolve some of the country's most pressing social problems.

**Key Words:** Saudi Arabia; Development; Petrochemicals; Labor

## I. Perspective

A sudden influx of new governmental revenues tends to bring with it ambitious visions. Plans for far-reaching development, impossible before the new money had been available, are introduced. This is particularly likely when the country concerned has been suffering from underdevelopment, and where the prospect of a rapid advance to a higher stage of development seems a real possibility.

There have been two occasions when the Saudi government has benefited from a sudden increase in the revenues at its disposal. The first was in the oil boom which occurred between 1973 and 1982, and the second began in 2003 and continues today. In each period the government introduced new and highly ambitious development plans. In the view of many observers, the development strategy pursued by the

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Saudi government in the first oil boom was flawed. The economy remained heavily dependent on oil, such that economic growth came to an end once oil prices declined.

This article seeks to answer the question as to whether the outcome of the post-2003 will be more positive than that of the 1973-82 boom. The experience of the earlier boom period will be examined in order to compare and contrast this with the current experience.

The assertion that there have been only two major oil booms in Saudi Arabia needs, first, to be justified. Some analysts regard the period between 1990 and 1992 as characterized by boom conditions. It is certainly true that oil prices and revenues rose sharply after the Iraqi occupation of Kuwait. This did not, however, constitute a boom. Most of the increased revenues which Saudi Arabia gained at this time were spent in financing the Gulf war effort against Iraq in 1991. Money had to be spent not only on Saudi Arabia's own defenses but also in financing the military activities carried out by the United States and its allies. The cost of the war to Saudi Arabia came to some \$60 billion.

## II. The Development Vision, 1970-85

The vision of development which was initiated in the first boom will be explained in this section. The period taken is that of the country's first three development plans. That period (1970-85) is rather wider than the years when oil prices were at their height. There is good reason for taking the wider perspective. Although oil prices rose most rapidly and dramatically after 1973, Saudi Arabia's oil revenues had in fact begun to rise significantly from 1970. The initiation of its 5-year development planning, indeed, was itself an indication that the government was confident that the resources for substantive change would be available. At the other end of the period, boom-driven development did not end immediately oil prices decline. Even though oil revenues fell sharply after 1982, the pace of development continued unabated. It had to as projects were already underway, and the development plan which was guiding economic policy remained in force up to 1985. The huge foreign assets which had been built up between 1973 and 1982 were drawn on to cover potential deficits.

Saudi Arabia's first three development plans conveyed an ambitious vision of social and economic transformation. They differed in size but not in concept. In all, the government sought to bring about substantive changes in the country's economy and society, with Saudi Arabia transformed from a backward and underdeveloped country to one having many of the attributes of a developed state. The First Plan (1970-75) was naturally cautious in so far as the rise in revenues was only just

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beginning.<sup>2</sup> The Second Plan (1975-80) was hugely ambitious: planned expenditure rose to 13 times that of the first plan.<sup>3</sup> Perhaps unrealistically, it aimed at rapid development in all sectors simultaneously. What had been distant objectives in the First Plan became short-term targets in the Second Plan. The Third Plan (1980-85) recognized the bottlenecks created by the Second Plan, and sought to focus the path of development more closely.<sup>4</sup> Nonetheless, planned development expenditure continued to increase, coming to approximately twice the level envisaged in the Second Plan. Actual expenditure was also substantially higher in the Third Plan period than in the Second Plan period.

Crucial to the development strategy was the rapid expansion of industrial and agricultural production. In the industrial sector, state involvement was increasingly focused on the petrochemical industry, seen as appropriate to the country's resource base. The Third Plan envisaged the development of new industrial cities in Jubail and Yanbu, and these were to be devoted mainly to the production of petrochemicals.<sup>5</sup> In agriculture, the objective was to make Saudi Arabia self-sufficient in certain agricultural products, especially cereals. Substantial subsidies made possible the rapid expansion of irrigated agriculture. Overall, relatively little attention was given to the private sector in the development plans.<sup>6</sup> It was assumed that private investors would play a role in commercial, light manufacturing, servicing and agricultural activities – as they always had done – but the major investments shaping the country's industrial development would all come from the state.

Massive investment was devoted to developing the country's physical and social infrastructure. Schools, universities, hospitals, and roads were created where there were none before. The declared objective of the educational expansion was to ensure that Saudi Arabia's new generation had ample access to education at every level, while the investment in health and welfare services was to provide facilities similar to those found in the developed world.

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<sup>2</sup> See *First Development Plan, 1970-75* (Riyadh: Central Planning Organisation, Kingdom of Saudi Arabia, 1970).

<sup>3</sup> See *Second Development Plan, 1975-80* (Riyadh: Ministry of Planning, Kingdom of Saudi Arabia, 1975).

<sup>4</sup> See *Third Development Plan, 1980-85* (Riyadh: Ministry of Planning, Kingdom of Saudi Arabia, 1980).

<sup>5</sup> *Ibid*, pp. 240-249.

<sup>6</sup> The Third Plan specifically states that "economic development is largely a government activity". *Ibid*, section 9.2.



A greatly expanded administrative machinery was required so as to create and manage the new activities. Up to this time, the Saudi state had not been capable of playing a significant role in economic and social development. The scope within which it could act was limited by resource constraints. Now it needed to act as the initiator, mainspring and sustainer of a huge transformative project. The character of the developmental project was not unlike that which socialistically-inclined Arab countries were pursuing at that time, but without the socialism. The number of those working in the civil service increased by more than 10-fold over this period.

### III. Achievements and Failures in Development, 1970-2002

To assess the achievements and failures of the 1970-85 development strategy, a perspective which stretches well beyond 1985 is needed. The objectives of the strategy were to bring about long-term and sustainable development. Such development could not be dependent simply on a high oil price. The infrastructural, industrial and agricultural foundations laid down between 1970 and 1985, then, were intended for the long-term: to ensure that continued economic growth was not dependent on a high oil price. As the oil price remained relatively low and unstable from the mid-1980s through to 2002, the whole period through to 2002 can be seen as a testing ground for the 1970-85 strategy.

In some respects, the strategy pursued in the first oil boom period achieved substantial results – in keeping with the targets which had been set. There was rapid growth of the physical and social infrastructure. The publications of the Saudi Ministry of Planning show that communications, educational institutions, health facilities etc were expanding several-fold under each of the first three development plans.<sup>7</sup> Expenditure was often even higher than had been envisaged, and the expansion achieved sometimes exceeded the targets. There was also a phenomenal growth in the size and complexity of the country's administrative machinery.<sup>8</sup> In the industrial sector, the new industrial cities of Jubail and Yanbu were duly completed, and the petrochemical industries were brought into production. In agriculture, land devoted to irrigated agriculture increased several-fold, and the country not only

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<sup>7</sup> See *Achievements of the Development Plans 1970-1989* (Riyadh: Ministry of Planning, Kingdom of Saudi Arabia, 2006).

<sup>8</sup> See Othman Al-Rawaf, "The Concept of Five Crises in Political Development: Relevance to the Kingdom of Saudi Arabia" (Duke: PhD dissertation, Duke University, 1980).

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became self-sufficient in wheat (and a few other agricultural goods) but also began to export some.<sup>9</sup>

Yet, in crucial respects the development strategy failed. The period which followed 1985 was, at best, one of constrained development. The pre-1985 strategy, aimed at creating a basis for long-term sustainable growth, had clearly not achieved its objective. Some of the limitations of the strategy and its implementation were becoming apparent. Infrastructural provision, for example, remained inadequate. While the statistics covering the provision of social and physical infrastructure continued to rise, this masked a deteriorating reality. The provision did not keep up with the needs of the population, and much of the existing infrastructure was deteriorating rapidly through insufficient funding for maintenance. Too much emphasis, moreover, had been placed on crude statistics and too little on the quality of what was being offered. Although there were a large number of children in the school system, for example, this did not mean that Saudi young people were benefiting from good educational facilities and services. The quality of what was provided ensured a very different outcome.

In the productive sectors, there were also problems. The development of the petrochemical industry was impressive but limited: the industry did not expand significantly beyond its initial base. In part this was due to its reliance on state funding (which was no longer readily available). In part, however, it stemmed from factors which were outside the control of the Saudi government. The industry's expansion was dependent on world markets importing Saudi petrochemicals. In the Western world there was a marked reluctance to do this. Tariffs protecting the home petrochemicals industries of Western industrialized countries remained very high, making it difficult for Saudi Arabia to exploit its comparative advantage in petrochemicals production.

In agriculture, the problem was different. Here the expansion of irrigated agriculture was simply misconceived. It required water to be drawn, at considerable expense, from the country's underground reservoirs. The grain produced could be sold on international markets only because substantial governmental subsidies supported its production and marketing. In addition, extensive irrigated agriculture lowered the water table in most parts of the country, with damaging effects on the environment. Saudi Arabia, a country with no natural rivers, was in effect using its financial resources to export water.

In addition to the problems inherent in the development strategy, there were also failings in how the government managed its finances and its priorities. Given that the oil revenues were now less than they had been, the careful use of these

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<sup>9</sup> Tim Niblock, *The Political Economy of Saudi Arabia* (London: Routledge 2007), pp. 120-122.



revenues was essential. In practice, however, considerable sums of money were wasted. Some of this was through corruption, or the pursuit of prestige projects which had little real value. The heavy expenditure on defense, which made up about 35% of all government spending at this time, was also significant. It reduced the resource which could have been used to support development.<sup>10</sup> The blame for excessive defense spending does not lie with the Saudi government alone: it was strongly encouraged by the Western powers which were benefiting from the arms sales. Saudi Arabia was being encouraged to see itself as a partner of the United States in countering Soviet influence in the region and beyond.<sup>11</sup>

Over the period covered by the Fourth, Fifth and Sixth Development Plans (1985-2000) Saudi Arabia's Gross Domestic Product grew by no more than 1.2% per annum, while the population was growing by almost 4% per annum. Per capita income had stood at \$22,000 in 1982; at the end of the 1990s it was no more than \$7,500.<sup>12</sup> It would be wrong to suggest, however, that the impact on the population was of this order. The per capita statistics reflect the changing price of oil, yet the income accruing from oil sales went to the government and not to individuals. Besides, the government was able to keep up a reasonable level of budgetary expenditure through reducing its foreign assets and borrowing on the international financial markets, and reducing its expenditure on infrastructure. Oil revenues, moreover, were still substantial enough to underpin the normal operations of government, such that the immediate and most pressing needs of the population were still being met. The ambitious visions had disappeared, but the government was still able to cope.

To some extent, it was the government's ability to cope which enabled it to avoid the economic reforms which were really needed. It was only between 2000 and 2003, partially to satisfy the requirements for Saudi Arabia's accession to the WTO (which was finally concluded in 2005), that serious economic reforms were instituted. It was in those years that the government introduced a raft of new laws to encourage private investment and a more competitive private sector.<sup>13</sup> The key measure here was the Foreign Direct Investment Law (2000), which for the first time

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<sup>10</sup> Anthony Cordesman, *Saudi Arabia Enters the Twenty-First Century: the Military and International Security Dimensions* (Westport: Praeger, 2003), p.77.

<sup>11</sup> Tim Niblock, *Saudi Arabia: Power, Legitimacy and Survival* (London: Routledge, 2006), p.145.

<sup>12</sup> These statistics are drawn from the *CIA World Fact Book*, accessed at [www.odci/cia/publications/factbook](http://www.odci/cia/publications/factbook) on 5 September 2008.

<sup>13</sup> The texts of these laws can be accessed on the internet at [www.sagja.gov.sa](http://www.sagja.gov.sa). See, in particular, Capital Markets Law 2003, Copyright Law 2003, Corporate Tax Law 2004, Foreign Direct Investment Law 2000, and Real Estate Law 2000.

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enabled companies operating in Saudi Arabia to be 100% foreign-owned. This was followed by legislation simplifying the tax arrangements for foreign companies, opening up the capital markets, and safeguarding intellectual property – to name only the most significant. The new legislation was intended to make it possible for Saudi Arabia to gain through foreign investment the resources which were no longer available through oil revenues. Paradoxically, this was being done just when the oil revenues were about to rise sharply once more.

Besides the problems outlined above, there was one further problem which was apparent in the Saudi economy over the 1970-2002 period. This problem will be described later in this article as critical to the success of economic development in the current oil boom period, so it is important to cover it here – although at the time it was not given so much attention. The problem was that the pattern of economic development which the Saudi government had adopted was not creating an economy where the population could be productively employed. Every plan from the Third Plan (1980-85) onwards talked of the need to reduce foreign labor and boost the employment of Saudis.<sup>14</sup> Yet every plan failed to deliver this.

The biggest indication of failure in this regard was the composition of the Saudi labor force, as split between the public and private sectors. At the end of the 1990s more than half of the Saudi labor force was still in the public sector. While many of these were no doubt performing productive and useful work, a significant number were not. In the private sector, some 90% of the workforce was non-Saudi. The government was proud of the record of the private sector in expanding at times when the wider economy was experiencing problems, but the reality was that it was doing this on the basis of migrant labor. The rate of Saudi unemployment was rising, and this rate would have been even higher if those who were not productively employed were included. This was perhaps the most basic failing of this period: the system was not catering for the needs of society in terms of enabling the population to be productively employed. The reasons for the failure will be discussed in section 6 below.

### IV. The Development Vision, 2003-

The path of the current oil boom is well known. In 2002 the oil price stood at \$24 a barrel. It then started a steady rise. In 2005 the prices of a barrel of oil reached \$50. At the beginning of 2008 it had reached \$104, rising further to \$149 in July 2008. At the time of writing (end-August 2008) it stands at \$102. The impact of this rise on Saudi Arabia's finances has, of course, been immense. Oil revenues rose from SR166

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<sup>14</sup> Third Development Plan, section 3.4.



billion (\$1=SR3.75) in 2002 to \$491 billion in 2002, and then to about \$600 billion in 2007.<sup>15</sup> Similarly large increases occurred in the size of Saudi Arabia's foreign assets. GDP at current prices rose at more than 20% per annum throughout the middle of the decade.<sup>16</sup>

The Saudi government was once again able to develop an ambitious vision for the country's economic and social development. This vision can be found in a variety of Saudi policy statements and documents. Most notably it finds expression in the Eighth Development Plan (2005-9),<sup>17</sup> the plans for 6 new "economic cities", and the Long-Term Strategic Plan (covering development through to 2024).<sup>18</sup> The introduction of the latter is particularly significant, indicating that the Saudi government does indeed have a strategy for the long term.

The central theme which emerges in the Long-Term Strategic Plan is that of making Saudi Arabia a global industrial power by 2024, with average per capita income doubling from about \$11,500 per annum in 2004 to about \$25,000 in 2024.<sup>19</sup> A GDP growth rate of 6.6 percent per annum at constant prices is required in order to reach this target. Investment expenditure will, it is envisaged, grow at 9.3 percent per annum, whereas consumption expenditure will rise by only 5.3 percent. The important role given to industry is reflected in its predicted share of GDP, relative to that of the oil sector. The share will increase from 19.6 percent in 2004 to 24.9 percent in 2024, while that of the oil sector will decrease from 27.5 percent to 17.9 percent.<sup>20</sup> The rate of growth of the industrial sector is expected to be about 7.8 percent per annum, as opposed to the 6.6 percent for that of the whole economy.

The industrial strategy is clearly targeted. Rather than encouraging all types of industry, the focus is on those which "rely on exploiting the country's comparative advantages", energy-intensive industries and investment-intensive industries.<sup>21</sup> On the manufacturing side, these three categories in practice lead to the same industries: petrochemicals (including downstream derivatives of petrochemicals – such as

<sup>15</sup> See Saudi-American Bank, *The Saudi Economy: 2007 Performance, 2008 Forecast* (Riyadh: SAMBA, 2008).

<sup>16</sup> See Saudi Arabian Monetary Authority, *Forty-Third Annual Report* (Riyadh: SAMA, 2007).

<sup>17</sup> *Eighth Development Plan, 2005-9*. (Riyadh: Ministry of Planning Kingdom of Saudi Arabia, 2005).

<sup>18</sup> The Long-Term Strategic Plan can be found in Chapter Three of the *Eighth Development Plan*.

<sup>19</sup> *Eighth Plan*, section 3.4.2

<sup>20</sup> The figure for industry includes mining, construction and electricity, as well as manufacturing.

<sup>21</sup> *Eighth Plan*, section 2.4.5 and 27.4.1. Also Fifth General Objective at start of Plan. Slightly different each time. Some of the sections on industry also list knowledge-based industry as a significant area for development. This, however, tends to be discussed in a rather general way which does not convey a sense of coherent plans or expectations.

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plastics and pharmaceuticals) and minerals (both extraction and processing). The potential for Saudi Arabia to emerge as a global industrial power rests, in particular, on the petrochemicals industry.

The services sector, especially banking and tourism, is also seen as an area of substantial growth. The rate of growth here will even exceed that of industry – 8.8 percent as against 7.8 percent. The growth is expected to arise in part from the use of upgraded communications and information technology. Services will constitute about 42 per cent of GDP by 2024. While this will exceed the GDP stemming from the industrial sector, it does not reflect the relative importance which the two sectors will have in the global economy. Only 9.6 percent of exports are expected to come from the services sector in 2024, whereas over half of all exports will come from the industrial sector.<sup>22</sup> Oil and gas exports will at that stage only constitute 36.7 percent of all exports.

In order to create the scientific and technological base for development, substantial investment in human resources and physical infrastructure is needed. The Long-Term Strategic Plan states: “The attainment of competitive advantage requires establishing a strong base for science and technology where its human, material equipment and institutional elements are all integrated”.<sup>23</sup> As is to be expected, education is regarded as particularly important in this, especially at the secondary and higher levels. The volume of university graduates is to grow at an annual rate of 8.2 percent annually, with their share of the total labor force increasing from 21.3 percent to 32.9 percent over the 2004-2024 period. Expansion at the secondary school level will also be substantial, with the share of secondary school graduates in the labor force rising from 27.5 percent to 44 percent.<sup>24</sup> The Long-Term Strategic Plan does not cover in detail the physical infrastructural needs, but these have been covered in other reports, plans and projections made in the last few years – in the period since the LTSP was produced. Extensive investment in water and power is envisaged, with projections that some \$200 billion will be spent over the next 20 years. In addition there are the plans for 6 new economic cities: the first one being the King Abdullah Economic City on the Red Sea coast at Rabigh, which will be followed by others in Madinah, Ha'il, Jizan, Tabuk and the Eastern

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<sup>22</sup> The precise figure coming from the industrial sector is not revealed in the statistics, as it is included with mining and agriculture in a category entitled “Other Exports”. The share of the latter in total is given as 53.7 percent. Almost all of the latter, however, will in fact be industrial exports. Agricultural exports are expected to be minimal, as also will mining exports. Most of the mined products will be processed within the Kingdom.

<sup>23</sup> *Eighth Plan*, section 3.2.3

<sup>24</sup> *Eighth Plan*, section 3.4.3.



Province.<sup>25</sup> In addition there is the King Abdullah Financial District being developed in Riyadh.

The vision which underpins all this is expressed by the Plan as follows:

By the will of Allah, the Saudi economy in 2024 will be a developed, thriving and prosperous economy based on sustainable foundations. It will extend rewarding work opportunities to all citizens, will have a high-quality education and training system, excellent health care for all, and will provide the necessary services that would bring about the best conveniences to all citizens.<sup>26</sup>

## V. The Prospects for Successful Development Today:

### Factors Affecting Success

There are two significant respects in which the framework within which Saudi Arabia is today trying to pursue its ambitious development strategy are different than before. Both relate to the way in which the Saudi economy relates to, and reacts to, the global economy. First, Saudi economic planning today displays a strong preference for private as against public investment in productive sectors. This reflects the view promoted by international financial institutions (the "Washington Consensus"), whose analyses of the Saudi economy in the past have been strongly critical of the extensive role which the state has played in the economy. Although the Kingdom today has ample resources to invest in the economy, therefore, it is in fact relying on private investment to play the lead role in developing industrial and agricultural production. This has been the case ever since the Seventh Plan (2000-4), which stated that private investment would play the central role in 'increasing the Kingdom's capacity to adjust flexibly to rapidly changing technological and economic conditions at the global level', and in 'raising the overall level of efficiency of the national economy through more efficient use of resources'.<sup>27</sup> That plan, as also the Eighth Plan, stressed that 'intensive efforts' would be exerted so as to bring about privatization. For the first time the Plan gave projections of the level of private investment which was expected over the five years and the fields in which that investment was needed. Private investment was evidently no longer an add-on contributing to the all-round development of the economy but was now a key

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<sup>25</sup> Saudi Arabian General Investment Authority (2008) , "The Pillars of Global Competitiveness, " accessed at [www.sagia.gov.sa](http://www.sagia.gov.sa), August 2008.

<sup>26</sup> *Eighth Plan*, section 3.4.2.

<sup>27</sup> *Seventh Plan*, sections 5.1 and 7.3.

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element at the heart of the economy. 71.2 per cent of all investment over the period covered by the plan would come from the private sector.

The context within which Saudi Arabia's current development vision is framed, therefore, is substantially different from the 1970-85 context. No longer is there the expectation that the state will be the mainspring of development. The path of development, therefore, will not be solely dependent on the continued receipt of substantial oil revenues – although these will no doubt be crucial in creating the infrastructural base necessary for development.

The second major change stemming from the global economy is Saudi Arabia's accession to the World Trade Organization, which finally took place in December 2005. The significance of Saudi Arabia's accession is indicated by the difficulties faced in the negotiations leading up to it. Saudi membership, in fact, took longer to negotiate than did the membership of any other country. The Kingdom first applied for membership in 1992 – at a time when the WTO itself was just in the process of being formed. In the course of the negotiations, the Saudi government had to answer a total of 3,400 questions, leading it to produce some 7,000 pages of documentation.<sup>28</sup> The central problem was that Saudi government and the major WTO powers (the US and the EU) were pursuing diametrically opposed objectives in the negotiations. Saudi Arabia's central objective was to secure access to global (especially Western) markets for its petrochemicals, and was intent on maintaining as much control as possible of its own domestic market. The US and EU's objective was to open up the Saudi markets to their own companies for investment and trade, while preventing entry into their markets of cheap Saudi petrochemicals which would threaten the survival of their own petrochemical industries.

The outcome of the negotiations was surprisingly favorable for Saudi Arabia, reflecting the considerable skill used by the Saudi side in the negotiations. In terms of the concessions made by Saudi government, these may appear substantial. In the course of the negotiations, it agreed to open up its markets by creating a more welcoming regulatory framework for foreign investment. Some fields which had previously been barred to foreign investors were opened up, customs duties were reduced, and the taxes paid by foreign companies operating in the country were lowered.<sup>29</sup> Foreign companies in most fields would be able to operate on the same basis as local companies.

In practice, however, the Saudi government retains a large measure of control over its domestic market. The fine print of the accessions agreement reveals

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<sup>28</sup> Saudi-American Bank, *Saudi Arabia and the WTO* (Riyadh: SAMBA, 2006), pp.3-9.

<sup>29</sup> Ibid.



restrictions which are not apparent in the headline titles. The government, for example, keeps the right to favor local firms when awarding contracts for government procurement. Given the substantial role which government procurement plays in the Saudi economy, and will do increasingly over the coming years when the new financial resources at the disposal of the government will be spent, this leaves an important instrument in its hands. The government can also insist that 75 percent of the labor employed by foreign firms entering the services sector are Saudi nationals – a stipulation which theoretically applies to Saudi companies, but can seldom be enforced due to opposition from the business community. Even the remaining 25 percent is also subject to limitations, relating in particular to the proportion of executive positions held by Saudis. Expatriate workers, moreover, will still need a work visa, and the labor-sponsorship system remains unchanged. The latter requires that foreign employees who change employment have to obtain release letters from their employer.<sup>30</sup>

The legal and regulatory changes which came in the wake of the negotiations for WTO membership, and which have had a substantive impact, were in fact reforms which liberally-inclined elements within the Saudi government had themselves wanted to implement – irrespective of the WTO agreement. The measures create greater opportunities for private investment, and de-bureaucratise the business environment, even though there remain significant ways in which local companies retain an advantage over foreign companies.

The gains which Saudi Arabia drew from WTO accession were also significant, and indeed were greater than might have been expected at the outset of the negotiations. These gains related primarily to the country's petrochemicals exports. Full access to global markets was assured once the transitions to the conditions of membership had been completed in 2009. The government was not required to give a commitment to change the pricing of feedstock or energy for Saudi-based industry, given that Saudi and non-Saudi companies were to be treated on an equal basis. ARAMCO would, therefore, continue to supply natural gas and natural gas liquids to the petrochemicals industry at prices which were substantially less than global prices. This represented a substantial achievement for Saudi Arabia. The value of the arrangement was enhanced by other developments which had been occurring in the

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<sup>30</sup> The information given on the accession agreement here is taken from the Accession Protocol, which is made up of the Schedule of Concessions and Commitments on Goods; the Schedule of Specific Commitments in Services; and the Report of the Working Party. However, it should be noted that a convenient summary of the changes introduced can be found in the SAMBA report mentioned in note 27.

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global petrochemical market. Under the Chemical Tariff Harmonization Agreement, initially signed by a number of chemicals-importing countries in 1995, tariffs on imports of chemicals coming from WTO member-states were to be reduced steadily. This was to take place over a period going through to 2010. Tariffs on chemicals, which had previously been high in many countries, were to be reduced to a maximum of 6.5%. The objective of the International Council of Chemical Associations was to seek further reductions leading to the elimination of all chemical tariffs for WTO members. All of the 64 chemicals produced by the Saudi petrochemicals industry are covered by the Chemical Tariff Harmonization Agreement, such that the gains to Saudi Arabia from this process of global tariff reduction will be extensive.<sup>31</sup>

The third factor which will determine whether the new development vision will be successful is that of labor. Saudi Arabia's labor market is, at least in the short-term, ill-suited to a competitive environment. The task of identifying and describing the labor problem is not easy, given that the country's employment figures are in some disarray. This disarray may in fact be an outcome of the problem itself. There is a wide gap between what the government is seeking to achieve and what actually exists. Employment figures produced by the Ministry of Planning reflect the most optimistic assessment. They show an overall total of 8,281,000 in the labor force in 2004, where Saudis made up 42.7 per cent of the total.<sup>32</sup> The Ministry of Labor figures for the same year give an overall total of 6,754,904, of which only 20.5 per cent are Saudis.<sup>33</sup> No doubt part of the discrepancy can be explained by the two ministries defining "civilian employment" (the concern of both) in different ways, but as neither provide a clear definition of the term it is difficult to be certain of that. There may also be different practices in counting laborers who are employed in the absence of legal authorization. One indication of the greater accuracy of the Ministry of Labor figures is that these are the ones used by the Saudi Arabian Monetary Agency. There is a possibility, therefore, that Saudi labor makes up little more than 20 per cent of the country's civilian workforce.<sup>34</sup>

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<sup>31</sup> Information on the Chemical Tariff Harmonization Agreement is taken from the website of the International Council of Chemical Associations. That on the impact on Saudi Arabia is taken from SAMBA, *ibid.*, p.17.

<sup>32</sup> *Achievements of the Development Plans: 1970-2005*. (Riyadh: Ministry of Economy and Planning, Kingdom of Saudi Arabia, 2006).

<sup>33</sup> Saudi Arabian Monetary Agency, *42<sup>nd</sup> Annual Survey*, (Riyadh: SAMA, 2006).

<sup>34</sup> The background behind these figures is covered in greater detail in Tim Niblock, *"The Political Economy of Saudi Arabia,"* (London: Routledge, 2007), pp.191-194.



The significance of the imbalance between foreign and Saudi labor lies in the difference between the rates and conditions of pay for each. In all but high professional occupations, the rates of pay for Saudi labor are some 2 to 3 times higher than that of foreign labor, based on the same levels of skills, qualifications and experience. Foreign labor, moreover, tends to be more flexible (in terms of where and how it is used), and more easy to dismiss if it is no longer needed. In short, foreign labor in Saudi Arabia tends to be competitive with that which is found elsewhere within the region, whereas Saudi labor is not.

What makes this problem more intractable in the case of Saudi Arabia, as against other Gulf states, is that Saudi Arabia has a fast-growing population with large numbers of young people who are (or will be) seeking employment. The rate of unemployment already appears to be relatively high. The unemployment estimates are as questionable as those on employment, but the statistics which are produced (together with the anecdotal evidence) suggests an upward trend. In 2002, when the government for the first time released data on unemployment, overall unemployment was put at 8.1 percent. The figure was based on data which had been gathered in 1999.<sup>35</sup> Despite concerted attempts to boost Saudi employment, the statistics released by the Central Department of Statistics and the Ministry of Labor show a steady year-by-year increase in unemployment since then. In 2002 the figure stood at 9.7%, in 2004 it had reached 10.9%, and in 2006 12.02%.<sup>36</sup> A 2007 figure prepared by the chief economist of the Riyadh Bank (Zahid Khan), using data from official sources, put the rate of male unemployment at 9 percent, and female unemployment at 22 percent.<sup>37</sup> Khan was of the view, however, that these figures underestimate the real numbers. Given the lack of clarity as to who is "available for work" (especially in the female part of the population), it is difficult to be sure. There is little doubt, however, that unemployment does constitute a problem in the Kingdom.

The impact of unemployment is intensified by the character of the age-groups most affected by unemployment. It is highest among those in their 20s. Almost 75% of the Saudi population are under 30, and some estimates have suggested that the rate of unemployment for the 18-30 age-group is about 30%.<sup>38</sup> The social effects which follow from high youth-unemployment can not be ignored. It has been the under-30s, and predominantly those who have failed to find satisfactory employment, who have fed the stream of Saudis travelling abroad to fight for radical

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<sup>35</sup> Saudi American Bank, *Saudi Arabia's Employment Profile*, (Riyadh: SAMBA, 2002), p.1.

<sup>36</sup> Saudi Arabian Monetary Agency, *43<sup>rd</sup> Annual Survey*, (Riyadh: SAMA, 2007, table 28).

<sup>37</sup> Khan, Zahid, *Riyadh Bank Weekly Briefing*, July 4<sup>th</sup>, 2007.

<sup>38</sup> "A Tipping Point in Saudi Arabia," *Christian Science Monitor*, August 15<sup>th</sup>, 2007.

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Islamist causes. The impact of unemployment, moreover, is beginning to be felt more acutely as a result of rising prices. After years in which inflation posed no threat to living standards in the country, Saudi Arabia had an inflation rate of more 11% in August 2008.<sup>39</sup>

The government does not have the option of standing back and allowing employment to be governed simply by cost-effectiveness. Such an approach would be neither just to its population nor politically feasible. The Saudi government has sought to resolve the employment problem by promoting Saudization, which is given emphasis in all recent development plans. The Ministry of Labor has taken a wide range of measures to impel business to employ Saudi labor and to reduce the employment of foreign workers. Over half of the allocations for development expenditure in the last two development plans, moreover, have been for human resource development, which is clearly intended to give Saudis the skills, training and specializations which they need if they are to provide the economy with cost-effective labor. These policies are laudable but they will not solve the problem in the short- or medium-term. As far as education is concerned, radical change is needed to the quality and content of education and training, not just in its quantity. The gap in cost-effectiveness is still very wide and will take considerable time to be bridged, and pressure on businessmen to employ the less cost-effective labor will make it more difficult for them to compete in global markets.

### VI. Likelihood and Limitations of Success

The centre-piece of the Saudi government's ambitious vision for the future seems realistically attainable. There is every prospect that, by 2024, Saudi Arabia will have emerged as a major industrial power. It has the ability to develop its petrochemical industry in such a manner that the country will take a major share of the world petrochemicals market. It is perhaps worth emphasizing here the importance of this industrial sector. "Petrochemicals" are defined here as chemical products made from raw materials of hydrocarbon origin. The downstream processing of petrochemicals leads on to the production of plastics, resins, fibres, solvents, pharmaceuticals and detergents. Global trade in petrochemicals is currently valued at some \$300 billion annually. Given the importance of this industrial sector, supplying so many of the basic consumer needs of society, Saudi Arabia's capture of a major share in the global petrochemicals market would clearly give the country some significance in world industry – certainly greater than that which any other Arab country currently possesses.

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<sup>39</sup> *Arab News*, December 25<sup>th</sup>, 2007.



The reason for the likely success of the petrochemicals industry will already have become clear from the earlier analysis of the terms of Saudi Arabia's accession to the WTO. The accession agreement gives Saudi Arabia access to the markets which the industry needs, and enables it to compete on a very favorable basis. For reasons which will be explained below, the factors which restrain and restrict growth in other parts of the economy do not, and will not, significantly affect the development of the petrochemical industry. The extent of the comparative advantage which Saudi Arabia enjoys in petrochemicals outweighs the additional costs stemming from Saudi labor practices (i.e. requirements to employ Saudis rather than the cheapest labor available). The impact of labor market restrictions, in any case, impinges less on the petrochemical industry than on other parts of the economy. The opening up of international markets will enable Saudi Arabia to emerge with a major share in the global petrochemical market.

A comparison between the price of natural gas supplied as a feedstock to the US and Saudi petrochemical industries makes clear the extent of Saudi Arabia's comparative advantage. ARAMCO supplies ethane and methane to the Saudi petrochemical industry at a rate of \$0.75 per therm. The US petrochemical industry buys natural gas at \$14 per therm. In the course of the WTO negotiations, the Saudi government maintained that its pricing of natural gas did not run counter to the principles of fair competition. Saudi natural gas, the government pointed out, is not sold for export due to the high cost of the infrastructure which would be needed to do this. The gas had previously been flared as a waste product, so there was no reason why it should be sold at global prices. It would, moreover, be supplied at the same price to Saudi and non-Saudi companies within the Kingdom, so there was no discriminatory practice present in that respect. Despite considerable initial opposition from developed countries, this position was ultimately accepted by the WTO.

This basis of comparative advantage is not significantly undercut by domestic Saudi factors. The petrochemical industry constitutes one of the "islands of efficiency" within the Saudi system, which has been able to operate effectively with a minimum of interference from the wider governmental machinery. It is significant that the industrial areas of Jubail and Yanbu, where most of the petrochemical industry has so far been located, operate according to regulations and procedures which are outside of Saudi Arabia's normal local administrative system. The parts of the public sector which the petrochemical industry relates to most, moreover, are ones which can also be seen as islands of efficiency: the Saudi Arabian Monetary Agency, the Saudi Arabian General Investment Authority, the mining company MAADEN, the Royal Commission for Jubail and Yanbu and others.

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Nor does the labor problem impinge seriously on the effective running of the petrochemical industry. This is one of the few areas where the Saudi educational system is producing expertise of the highest caliber. The King Fahd University for Petroleum and Mining, where the instruction is in English, and the specializations studied are predominantly in the scientific and technological fields, graduates engineers which are as good as those as those graduating in the developed world. The petrochemical industry, moreover, does not require a large workforce. It needs a small number of highly-skilled and qualified personnel, and these are mostly available within the country. Their rates of pay are comparable to that which would be available on global labor markets. Where outside personnel are needed, the links which the petrochemical industry has within government and the resources at their disposal ensure that it can recruit from among the best.

The regulatory changes affecting foreign investment are also beneficial to the petrochemical industry. It needs to expand through alliances with foreign companies and the involvement of investors who bring with them technological knowledge. This will, in particular, be a necessity with the pursuit of a strategy aimed at obtaining major shares in global petrochemicals markets. The presence of foreign partners may also shield the Saudi companies further from unwarranted interference by the government in their activities. Their ability to cut through bureaucratic obstruction, and to seek legal redress if they are wrongly treated, will be enhanced. Saudi Arabia will also, increasingly, become a major investor externally in petrochemicals projects. SABIC's involvement in a major petrochemicals project in China, announced in the course of 2007, is a harbinger of that.

Thus the petrochemical industry has a very strong potential to use its comparative advantage to obtain a substantial share of global petrochemicals production. It already has 10% of this market, and that percentage seems likely to grow significantly. Some other industries will also enjoy a comparative advantage on the basis of the cheap supplies of petrochemicals which they can obtain within the country. Among those which are currently being promoted for the new economic cities are factories for fertilizers, packaging (310 plants), tires, and toys.

Cheap energy, together with the plentiful supplies of bauxite within the country, will also give the aluminum industry a substantial comparative advantage. There are at present plans for 10 alumina refineries (refining bauxite into alumina) in the new economic cities and 10 smelters (refining alumina into aluminium).<sup>40</sup> The objective is for Saudi Arabia to produce some 6.25 million tons of aluminum per annum – a substantial amount given that it would make Saudi Arabia the second

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<sup>40</sup> Saudi British Bank, 2007, p.34.



largest aluminium producer in the world, after China. These developments will clearly be important, but as with petrochemicals it is unlikely that they will employ large numbers of Saudis, and the multiplier effects on the economy may be limited.

While the prospects for the petrochemical industry are very bright, the same can not be said for the rest of the economy. For all those areas where Saudi Arabia does not have a clear existing comparative advantage, the opening up of the country's domestic markets to global competition (to the extent that it does occur) is problematic. As has been shown above, labor in Saudi Arabia is likely to remain more expensive than in the countries with which Saudi goods would have to compete. The more the economy is opened up to the forces of global competition, the more difficult will Saudi business find it to employ Saudis. Using costly Saudi labor, rather than cheap migrant labor, will price Saudi products out of most global markets. Even domestically, many local businesses will be unable to compete with companies which are based outside of the country.

In practice, the outcome is unlikely to be as negative as this. As noted above, the terms of Saudi Arabia's accession to the WTO will enable the government to retain substantial control over the domestic market. While this may protect parts of domestic production, however, it will not help Saudi businesses to compete in global markets. The positive impact of globalization, then, is reduced by limiting its scope. The possible gains which tend to ensue from globalization elsewhere become more limited.

## VII. Towards a New Social Contract?

The prospects for Saudi Arabia's economic development, then, are paradoxical. The core elements of the government's development vision may well be realized. It seems unlikely, however, that this will solve the most pressing social problem which the country is facing: growing unemployment. The parts of the economy which will expand, making Saudi Arabia a global industrial power, will not employ large numbers of Saudis. Those economic activities which do normally absorb substantial quantities of labor, on the other hand, are unlikely to grow significantly. The dilemma in which the Saudi government finds itself is not the effect of policy failure. It is structural. The labor market and the problems which arise from it have arisen from the rentier dimension of the economy. The government itself is a victim of these dynamics.

There is a means by which the Saudi government could escape from the dilemma in which it finds itself. It could move towards reducing the wages and salaries paid to its own citizens. If these stood at the same level as the rates at which migrant labor is paid in the Kingdom, domestic businesses would be able both to

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fulfill the government's requirements on the employment of Saudis and to operate competitively in global markets. In practice, this is a policy which any government (anywhere in the world) would find it very difficult to implement. The population would resist so drastic a reduction in living standards (wages and salaries would need to fall to about one-half of existing levels). If the policy were introduced gradually, and were accompanied by measures which offset the fall in income, however, it might become feasible.

What would be needed would be a new social contract, where the welfare provided to the population was substantially improved – in return for a lowering of wages and salaries. The provision of higher quality (free) educational and health facilities, unemployment benefits for those made unemployed, comprehensive pensions provision, subsidized housing and access to mortgages (the majority of the Saudi population live in rented accommodation) would offset the loss in income. There is no doubt, however, that a policy of this kind would require a carefully-planned and perhaps risky political strategy. The character of the new social contract would have to be readily apparent to the population. The ambitious vision for the future, therefore, may need to be political rather than economic.

