

# State Influence in Economic Development in Saudi Arabia

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## Introduction

All too often is Saudi Arabia seen as the most influential player in the Middle Eastern region. Not only does the Kingdom have one of the highest funded military, it also houses the largest oil sector of the region. Unlike other oil rich gulf countries Saudi Arabia has a relatively sizeable population. The Kingdom is also the single largest economy of the Middle East. The economical base on which the Saudi political system is built is quite unique. Several other nations are regarded as having the same political-economical system, the rentier state, but Saudi Arabia is the most prime example. As will be explained in this thesis, rentier states boast enormous public sectors. In the case of Saudi Arabia less than 5 percent of the population is engaged in the production of oil, whereas 80 percent of the population is employed publicly. Since the oil sector is responsible for about 50 percent of GDP and almost all government revenue it becomes clear that the distribution of oil wealth plays a large role in the Saudi economy. This distribution is what makes Saudi Arabia a very interesting case when it comes to economic development, since the power over the population coming from this distribution of funds means that the state can be influential in many parts of society as well as in the economy. This thesis will ask the question to what extent the Saudi Arabian state has had an influence on economic development in the country in the period following the oil boom of the 1970s to the recent period. As this question the Saudi financial spending this thesis will touch on many parts of Saudi Arabian economic development and society. Firstly it will establish the state of the art of Rentier State Theory. In doing so it will explain the importance of this field of research in the understanding of Saudi economic development. In doing so the thesis will look at reforms made in the Saudi economy during the period from the oil boom, also going over the Rentier State Theory's recommendations towards further reforms. Secondly the thesis

will go into the field of Human Resources. In the Saudi economy many foreign workers are employed in many different economic sectors. The reason for this, as well as how the way the state influences the dependence on foreign workers will be analysed. Lastly this thesis will look at the sector Saudi Arabia is not famous for: the private sector. In many countries the economy is comprised of primarily this non-state owned sector. This thesis will go over what the Saudi private sector looks like and why it is important for future economic development. Finally it will take recommendations from existing literature towards the goal of reforming the Saudi economy with regards to government intervention and the role of private sector actors.

# 1 Rentier State Theory

## 1.1 Introduction to Rentier State Theory

This thesis has been written with the aforementioned questions in mind. A few things have to be cleared up before getting into the actual analysis however. Firstly, the notion of state and the characteristics of a so called 'rentier state'. The rentier state will be the main subject of this chapter. The textbook by political scientist John Waterbury gives a definition on the subject of 'rent'. He defines rent as the difference between the world market price of a good or service and the domestic opportunity cost for production. If the assets are of strategic value, the export price can be set much higher than the cost for production which leads to a large influx of money to the country (Waterbury 16). These assets can be of nearly any kind: strategic importance in the case of Israel, shipping fees for passage through the Suez canal for Egypt or raw resources like oil for Saudi Arabia. Although the notion of a rentier state is also often used for countries like Norway (with just about 25% of total revenues coming from oil) (Qasem 42), the Saudi case is a much more explicit example. Kandil describes total government revenue share for oil as being as high as 89% in 2010, with the oil sector directly responsible for over half of the GDP (5964). This extreme importance of oil revenue and the production in the oil sector for the economy sketches how essential the foreign rents are for Saudi Arabia.

The extent to which the oil sector is ingrained in the economy does not only lead to the economic importance of the sector. The rentier state system also allows for certain social constructs. Government revenues are already mostly accounted for from the external rents from foreign oil producers. This means taxation is not necessary in large government projects, some examples of which will be dealt with later in this thesis. The notion that brings Rentier State Theory (RTS) in the picture is the influence the large foreign rent

influxes have on other exporting sectors. Large foreign currency reserves are used to a large extent to import produced goods, leaving domestic production sectors underdeveloped. Lack of a domestic manufacturing sector can cause society to “dwell in a state of underdevelopment” (Qasem 27). Rentier State Theory is the academic discourse surrounding the state of affairs in countries with a significant share of government revenues flowing from rents from the production of raw materials. This theory explains many policies in the oil producing states of the gulf including Saudi Arabia. As the main benefactor of the external rents gained from the production of oil, rentier states become majorly engaged in the distribution of wealth. In Saudi Arabia only a fraction of the population is employed in the oil sector whereas the state employs many more nationals, essentially redistributing the wealth acquired from the hydrocarbon industry (Beblawi 52).

The layers of benefactors of oil wealth in society have a distinct role on the shaping of the state. Whereas the state usually puts itself in charge of providing of goods and services to the population by raising taxes the high amount of money flowing in from rents means taxes are not necessary (Beblawi 53). The absence of taxes in the rentier state means the population will generally ask far less participation in the state’s affairs, and also that the ruler is elevated to the position of a generous giver. In Saudi Arabia the position the ruling family creates has led to the social ability of the princes of the house Saud to take something in return for their services provided. One way many princes manage to get personal gain from their positions in the government is through the acquisition of contracts. Companies owned by royals therewith have access to many more projects. This kind of involvement blurs the line between public and private affairs (Beblawi 55). Seen as many government officials tend to do business with family or otherwise related enterprises it is almost impossible for foreign investors to work in Saudi Arabia without a domestic partner.

To summarise: a rentier state is a state in a particular economic situation. The influx of high amounts of foreign money from the exploitation of a resource leads to certain economic challenges as well as advantages. Rentier state theory is the academic discourse surrounding states boasting a rentier economy. It describes how the distribution of wealth has consequences for a country's economic and social situation.

## 1.2 The Saudi Rentier State

Current RST is not as straightforward as classic or orthodox Rentier State Theory. The classic view of the state was the legislative organisation which exerts the monopoly on the legal use of violence in a society, including the social structures maintained by a government. This view is less well defined in more recent views of RTS becomes clear in the essay by Hertog. In this essay he deals with the notion of 'corporatism': a system where many public and private units that are "recognized or licensed" by the state are made responsible for a certain aspect of legislation (Hertog, *Modernizing without democratizing?* 67). Seen as the state grants power over a certain part of civil society to these corporations, the state is enabled to appoint leaders to them. Civil interest groups are therewith controlled by the state, regardless whether they are part of the state or not (Hertog, *Modernizing without democratizing?* 67). The effects of corporatism on state affairs is large, Hertog argues. One example of an interest group indirectly influenced by the state is the Human Rights Association, in part licensed and funded by the Saudi state. Bottom-up civil societies apparent in many modern states are with the system of corporatism made much less influential (Hertog, *Modernizing without democratizing?* 68).

One group which to a certain extent is exempted from this government intervention is businesses (Hertog, *Modernizing without democratizing?* 74; Luciani 177). Luciani's main argument is that the rich private class, which he calls the national Bourgeoisie, is

increasingly self-governing. In the system of corporatism in which many societal interest groups are stuck, the Bourgeoisie is able to press through some of its politics to the government. While many of the examples of businessmen engaging in politics Luciani brings up have links to the government or the royal family, all of them are able to press their economic agenda to the legislative level. One of the most influential industrial owners of Saudi Arabia has been increasingly engaged in politics, even touching on international cooperation and the position of women in corporate affairs (Luciani 179). Even though this example seems to be a confirmation of the corporatist structure Hertog depicts it should be seen as the opposite. Whereas in a corporatist situation there would be top-down state control, in this case there is an interest group that has managed to create bottom-up influence on state affairs.

For Rentier State Theory this notion is important as it shows that private sector businessmen in Saudi Arabia are increasingly influential in the economy and politics (Luciani 180). Businesses have become the exemption to government intervention due to the increasing dependence of the regime on the private sector (Hertog *Modernizing without democratizing?* 74).

Clientelism is defined by Hertog as the framework of relationships between different actors in the economy, neither operating on equal footing nor with an inclusive mindset. This includes the social welfare system in the country but also the growing number of government employees. This employment can even be seen as another way to distribute funds to the populace since overemployment is “so obvious” in the public sector (Hertog *Saudi Economic Reform Efforts* 125). Clientelism as a framework is one of the main reasons for the issues concerning workers’ mentalities that will be dealt with later.

The notion that entrepreneurs play a role in how the state is run poses a problem. Historically, the economic elite has played a large role in the democratisation and



liberalisation of the economy. This would be undesirable for government in the autocratic Saudi state (Hertog *Modernizing without democratizing?* 76). Most often have efforts towards liberalisation or democratisation been in order to increase economic efficiency. The current state of affairs in Saudi Arabia creates a curious situation. Government grants for the corporate sector lead to an economic advantage for businesses, so that the monarchy is economically efficient to sustain from the viewpoint of entrepreneurs (Hertog *Modernizing without democratizing?* 76).

Because state employment is no longer sufficient to employ the growing Saudi population, the government's focus has been put on the private sector. This sector is to lead future economic development and diversification (Hertog *Modernizing without democratizing?* 74). The line between public and private has been blurred by constructions like corporatism and clientelism. Several reform programs will be needed before the private sector can fulfil the role the state can no longer maintain.

### **1.3 Reform Programs Analysed within RST**

The need for a more private focus of the economy has not gone unnoticed by the Saudi government. Several rounds of reforms can be seen throughout recent history. As Malik states these reforms are mostly passed not in periods when they are needed but in periods when oil prices are high and economic growth is not of concern (85). In the years following 2000 oil prices have taken on a relative high level, which would on first thought diminish the need for budgetary reforms. These are most often a result of strains on government budgets. These years have actually seen one of the most quickly made reforms in the recent past. The reason Malik puts forward for this trend is twofold. Firstly there has been a growing feeling of discontent due to a falling standard of living and rising

unemployment levels for Saudi nationals. Secondly international pressures towards a more liberal set of policies has increased after the attacks on the WTC in 2001 had fuelled suspicions that Saudi policies were aiding international terrorism. Malik states that in the light of international pressure economic reforms are less controversial and less problematic to enact than political reforms, which is a reason why economic reform came to be more prominent in this period (86). Hertog acknowledges the mounting pressure towards reforms. The economic reforms have not yet changed the existing linkages between the Saudi government and economy. The corporatism defined earlier has led to a decline in the interest groups that in other states exert pressure on redistribution of means (which in the case of Saudi Arabia would be distribution of oil rents), as these interest groups are governed by the state itself (Hertog *Saudi Economic Reform Efforts* 113).

In order to reform the economy several reform programs have been set up. For example, Saudi businesses have become more influential in politics. As the Saudi bureaucracy is obtrusive to business owners many complaints have been made, leading to a slight retreat from interfering in businesses. Hertog however calls the regulations towards keeping control over the economy a problem, as well as the increasing number of princes engaging in the private sector, creating difficulty for the non-royals (*Saudi Economic Reform Efforts* 126). What is more, several new administrative structures have been created to push through the reform programmes (Malik 86). These structures have been focussing mostly on attracting more Foreign Direct Investment. Private sector employment is a larger focus for the Saudi government, so having foreigners set up businesses and employing Saudi nationals is desirable. Reforms have included easing the rules towards which projects could be started, so that more enterprises would eventually start up.

Tax reform for Foreign Direct Investment was changed from charging 45 percent corporate tax to in most cases charging no corporate tax, depending on the sector (Malik

89). Since other gulf countries like the United Arab Emirates charge no corporate tax competing for influxes of Foreign Direct Investment before this tax cut was particularly difficult. Another means to draw in foreign investors to Saudi Arabia has been to formalise tax standards. These reforms would lead foreign investors to be more confident investing in the Saudi economy (Malik 90). Another example in which foreign investors' confidence was attempted to be increased was the reformed law on intellectual rights (Malik 92). This intellectual rights law was one of the reforms needed to aid the negotiations with the WTO (World Trade Organisation).

Accession to the WTO was not universally seen as helpful, since it would include the principle of non-discrimination, rendering many protective policies towards both nationals and companies like Saudi Aramco impossible to maintain (Hertog *Saudi Economic Reform Efforts* 131). The Saudis would however gain access to the WTO's aid for trade liberalisation. The non-discrimination principle would also mean that trade partners would have to lower import tariffs on Saudi petrochemical products (Malik 96). The main trade-off is the need for far higher efficiency for domestic companies as foreign competitors can operate on the Saudi market with less import tariffs imposed on their produce (Malik 98).

#### **1.4 Recommendations for Reform**

The RST supplies several recommendations for reforming the economy. As the bloated private sector has recently not been sufficient to keep nationals employed, the unemployment figures have risen to relatively high values (Malik 86). As high unemployment and falling oil prices put large strains on government budgets as well as

social structures certain economic reforms are needed in order to create sustainable economic policy.

As the Saudi economy employs large numbers of foreign workers while at the same time having very high unemployment rates, it can be clear that there is a serious incompatibility issue between the Saudi labour market's supply and demand. Malik makes clear that the efforts made by the Saudi government to combat this incompatibility are not to be underrated (103). They have however not been sufficient. Not only do the reforms made have to be more radical, there are also more different changes needed (Malik 104).

Part of the issue of unemployment does not come from just the incompatibility between jobs and workers, but from a reluctance against some jobs. Malik suggests to change this attitude in order to get to a better participation of Saudis and to get a better functioning private sector (109). The ways in which this mentality change can be achieved will be explored later.

In short, Saudi Arabia can be classified as a rentier state. The large inflow of rents create an interesting economic and political situation. This chapter dealt with how government structures work in relation to society, analysed within the framework set by the Rentier State Theory. Since the linkages between state and society can no longer be maintained in the current economic situation, several policy changes will have to be made. Examples of changes the Saudi government has instituted will be discussed in the following chapter.

## 2 Human Resources

### 2.1 Foreign Worker Employment

Saudi Arabia faces a large employment problem in the future. Economists dictate the best way to keep the population employed is to have a higher economic growth than population growth. This balance has been disrupted in the Saudi economy. Economic growth between 1990 and 2000 has annually been around 1,6 percent while the population has grown by 2,7 percent annually (Looney 1). This trend means that the average income per capita, the first indicator of welfare, has been declining for decades. Another problem with the growing population has been unemployment. Even though the oil industry and related sectors have boasted a high growth percentage since the 1970s, unemployment figures have risen dramatically. Youth unemployment has even reached 30% in 2004 (Looney 2). Many of the jobs that have been created since the oil boom have gone to foreign labour, leaving out the growing Saudi population.

One of the most important drivers for economic growth are investments. Investments have been higher than projected, but their effectiveness in encouraging economic growth has been lacking. Looney puts the reason behind the ineffectiveness of investments on economic reforms weakening links between public and private sector investments (3). Public spending can no longer provide enough new jobs for nationals as it could in the period after the oil boom. Employment for the growing Saudi population is therewith dependent on the private sector.

As previously mentioned, the trend of a growing population not leading to a higher GDP creates pressures from the population to the government to increase available jobs. There has however been a trend in the Saudi economy against the employment of Saudi nationals. From the start of oil production the labour-poor region has become extremely

dependent on foreign workers. In fact, only 36 percent of the labour force in 2010 was composed of Saudi nationals (Al-Asfour 244). Due to the fast growing population 60% of the population is younger than 21. With employers there is a general opinion that Saudis will demand six times the salary a foreign worker would, while not working as hard (Mellahi 90). With this young population that has serious issues finding work in the private sector, the problem for employment for Saudi nationals becomes clear.

Aside from societal pressure and the risk for unrest, this situation is far from ideal economically. Around six percent of the size of the Saudi economy flows away in the form of remittances. As foreign workers are to a large extent employed as just temporary workers, there is little incentive for them to spend their wages in the kingdom (Espinoza 44).

The framework in which foreign workers are employed is typical for the economies of the Arabian Gulf. The migrant worker's work permit is tied to a 'sponsor', normally his employer. The dependence of workers on their employers can easily lead to abuse. Most workers arrive through recruitment agencies which charge them large amounts of money which the workers have to borrow. The combination of the dependence on the employer and the large accrued debts leads to situations of forced labour (Espinoza 43). Saudi agricultural workers on average earn nine times that what a foreign worker asks for (Espinoza 46). Competing with foreign labourers on the lower skilled jobs is therefore nearly impossible (Espinoza 47).

In the situation as it was around 2000, the division between nationals working in the public sector and foreigners working in the private sector of the economy was clear. Administrative workers were composed almost exclusively of Saudis while agriculture, transport and other lower skilled labour was taken up by foreigners (Mellahi 89). The reasons for this disparity are political, economic as well as social. As the Saudi judiciary

system is based on the notion that the state is run by the royal family, several aspects of labour markets as known in other countries are ineffective or non-existent. Labour unions and labour laws are for example directly related to the rule of the king. Whereas in many Western countries workers are able to collectively push an agenda through unions, Saudi Arabia does not have any non-state ruled worker's unions. Development of unions has not been actively pursued in the period from the oil boom to 2000 (Mellahi 88).

Economic factors playing a role in the creation of the aforementioned disparity between foreign and domestic labour are twofold. Firstly, as mentioned high population growth has led to a large young population. Whereas historically the public sector has provided for jobs this has become impossible to continue. The Saudi public sector is too bloated in order to employ more labourers. The growing Saudi population will, therefore, have to be employed in the private sector. Secondly however, there has been a large influx of foreign labourers in the oil sector and other labour intensive economical activities. As mentioned before, foreign workers are much cheaper to employ than Saudi nationals. Combined with the social factor: the assumption that Saudi workers are less productive and less disciplined, Saudi employers are little inclined to hire Saudi youths rather than importing low skilled labour. Similarly those unemployed youths are little inclined to accept manufacturing jobs as the societal status of those jobs is below their, and their parents', pride (Mellahi 90). As will be explored later in this chapter, the Saudi government has started some new initiatives towards the employment of Saudi nationals in the private sector. The rest of this chapter will deal with three general kinds of these initiatives: increasing human capital of Saudis through education, discouraging the employment of foreigners through regulation and attempts at including women in the labour market.

## 2.2 Educational Reforms

One of the more characterising aspects of Saudi governmental influence in the formation of a more balanced workforce is education. Enormous portions of development money given out by the government have gone into this sector. Up to over 50 percent of government spending has gone into Human Resource Development (HRD) (Al-Shammari 44). This equates to over a quarter of government spending going into education in 2008 (Espinoza 66). Despite these investments and the gains made from the 1970's to the 2000s there are still major issues in this sector of HRD. Although the number of graduates has been increasing in the period they have not been able to create innovation in- and increase the competitiveness of the Saudi economy (Khorseed 150). Khorseed mentions two reasons for this. First of all the relative number of graduates still lags behind many developed countries. Furthermore many employers feel that the skill sets of Saudi graduates are inadequate for their aspired work position. Secondly up to 25 percent of Saudi graduates actually emigrate in order to work abroad, draining the Saudi economy of knowledge (Khorseed 150).

A reason for this brain-drain and lacking innovative industry can be seen in the investment behaviour of Saudi investors. As investments in technological or other modern start-ups are quite risky, many Saudi investors do not engage in them, making it very difficult to start a new company as a young graduate. In order to accomplish the goal as set in the development plans to become the region's technological leader, this reluctance to invest in high tech companies can be a real issue (Khorseed 151).

An important note to make in the discussion of education reforms in Saudi Arabia is the structure of the educational system. Schools only have a small opportunity to have an own agenda as the Higher Council of Education is responsible for everything ranging from planning and approving education policies, formulating curricula, and creating exam



regulations (Al-Shammari 48). Goals of this Council are the eradication of adult illiteracy, but also having students acquire religious knowledge (Al-Shammari 44). So aside from the skill acquisition and interest based curriculum, the educational system is also established for ideological and religious aspirations. Al-Shammari explains the religious goals of the Council as follows:

“[The Islamic objectives] include strengthening Islamic faith; reinforcing respectfulness of general properties of others granted and protected by Islam; acquiring individuals with essential concepts, affections and capabilities to carry out the message of Islam; and creating a systematic perceiving approach in individuals to appreciate and understand the world, human being and knowledge from an Islamic perspective.” (Al-Shammari 45).

In brief, education is an essential aspect in the reform of HRD, and therewith economic development in the state. Several changes have to be made though, as the system previously described does not produce sufficiently adjusted graduates for the (private) labour market. In response to this, the Saudi state has started the King Abdullah overseas scholarship program in 2005. This program promotes Saudi student to study specific degrees abroad which fall in line with the needs in the Saudi economy (Yusuf 99). The training of highly educated workers diminishes the dependence on foreign labour in higher positions (Yusuf 99).

Proper education for students is needed for the development of the Saudi economy, but similarly work attitudes have to be changed in order for those students to be able to engage productively. It is not due to a lack of jobs that employment is lacking for young Saudis. As mentioned before, many jobs are socially unacceptable to many unemployed, who prefer to be employed in the public sector or in managerial functions. One explanation

for the entitled feeling toward many jobs are the privileges Saudis enjoy on the labour market compared to foreign labour (Yusuf 102). These privileges include a far higher pay, Saudi agricultural workers, as mentioned before, earn up to nine times the amount a foreigner would get (Espinoza 46). It is also seen as a right to have a salary as high as or higher than what the government pays when working in the private sector. This leads to many graduates remaining unemployed instead of taking lesser paid jobs. Graduates from the scholarship program prefer to be employed in the private sector, but only for large companies, leaving out medium or small sized businesses. This characteristic of the Saudi workforce works against one of the more influential programs started by the government in the field of HRD, Saudisation.

### 2.3 Saudisation

Saudisation is a separate solution to the same problem sketched above: that nationals in Saudi Arabia are having difficulties in finding jobs in an economy where many more workers are needed. Saudisation is also a response to the growing dependence on foreign labour in the Saudi private sector. This dependence not only comes from labour intensive sectors but also increasingly in knowledge-based industries (Looney 2).

Saudisation was officially enacted a while before 1990, but it was not until 2003 that the more influential initiatives have been enacted (Looney 3). It is an effort to decrease several problems mentioned before: the decreased employment numbers for Saudi nationals, the dependence on foreign workers and decreasing the amount of remittances flowing out of the Saudi economy (Looney 3). The program issues laws that dictate quota for a maximum relative amount of foreign workers to Saudi employees, or by outright banning employment of foreigners in certain mostly administrative sectors (Looney 4).

A general goal of Saudisation is having 25 percent of the total employees in the private sector be Saudi. As one of the largest companies in Saudi Arabia and it being run by the state, Saudi Aramco is a company to set specific quota for Saudisation for partner companies. This is measured simply by looking at how many Saudis are employed to how many foreigners (Looney 5). Not only are quota put on the private sector or on individual companies, there has been a plan to have a maximum number of expatriates live in Saudi Arabia by 2013. Aside from a maximum amount of total foreign workers, there are plans for imposing a maximum share of expatriates from a single country. This would mean that no more than 10% of the total number of foreign workers can have the same nationality (Looney 5).

Whether or not Saudisation will have the intended results depends on many factors, arising from several challenges. Firstly from the private sector itself. As companies are always looking for ways to increase profits, one cost that has been easy to save money on is labour. Many small to medium sized businesses almost exclusively hire foreign labour. On average, up to 94% of employees is expatriate in these companies (Al-Shammari 178). Due to the abundance of foreign labour willing to accept much lower salaries in the period before Saudisation, there is still a reluctance in the private sector to pay more for Saudi workers. However, Al-Shammari notices that if a Saudi employee manages to prove himself useful, his pay would generally be raised to levels higher than expatriates would receive (182). However, seen as for many potential Saudi labourers the fact salaries are relatively low in manufacturing and other private sector industries, another issue in the implementation of Saudisation measures becomes clear. Many Saudis are ill-inclined to look for jobs in the private sector, as previously mentioned. "Saudi youth prefer government jobs for they have good salaries in comparison to the effort an employee may exert. Saudis should accept the low salaries at the beginning of their careers as they will

get better as they progress in the private labour market.” (Al-Shammari 187), is a response from a private employer in Saudi Arabia asked for his opinion on the success of Saudisation.

A third source of problems for enacting Saudisation policies can come from the government’s own employment policies. Given the top-down nature of the legislative sectors in the Saudi government, few of the legal limitations put up have a direct link with the reality of businesses. This creates a discriminatory HRD situation where Saudi workers are favoured by law in their employment, while companies are forced to take in less foreign workers (Mellahi 94). On top of this imbalanced labour market in the private sector, the large job availability in the past in the public sector has led to the belief that there is a better job security in public sector positions or in working for semi-governmental organisations (Al-Shammari 183).

In order for Saudisation to play a reasonable role in economic reforms in Saudi Arabia, several initiatives should be taken for increased efficiency. Instead of having quotas set for Saudisation, more emphasis should be put on market forces in the labour market. This can be done in three ways. Firstly, by increasing the cost of hiring foreign labour. Secondly by decreasing the cost of Saudi workers by for example lowering firing costs or by lowering the social welfare benefits of working in public sector jobs. Lastly, by increasing the value of Saudi workers compared to foreign labour by investing in education and in infrastructure as to increase productivity of Saudi workers (Looney 5).

All in all, the Saudisation policies are a rather short term solution to a serious problem in the Saudi economy. Its goals could be aided by investing more in education, by having a less rigid system where different sectors are handled differently and by addressing social issues like minimum wages and women participation (Looney 9; Al-Asfour 251).

## 2.4 Women in the Saudi Workforce

Women participation in Saudi Arabia is undisputedly low as estimates are that 5 percent to 15 percent of women hold jobs. One more way for lessening the negative influence foreign workers have on the Saudi economy is by engaging the female population more in the economy. Of these female workers the vast majority works in the public sector, most notably education (Al-Shammari 36). As previously mentioned a major obstacle for reform in Saudi Arabia is a drop in welfare, and having women participating in the job market and earning a salary can reverse the trend of dropping income levels while not harming Saudi competitiveness (Wilson 147).

Al-Shammari mentions a number of reasons for the level of employment for women. Cultural and religious restrictions mean that women are faced with social pressures, meaning women cannot work overnight, nor far from their families. In fact women are not allowed to drive themselves and therefore require a private driver for transportation. It is also required for employers to create special working environments for their female employees. Another reason for lacking female participation is the way Saudi education caters for women. No technical, administrative or business educational institutes exist in Saudi Arabia that have adapted to women's education (Al-Shammari 37).

Education is the go-to sector to get women more involved in the job market (Yusuf 100, Qureshi 150). By investing in a more suitable education system unemployment rates should not only drop for female graduates, but they should also help female employees climb higher on the corporate ladder, keeping them from quitting their jobs when they have kids. As the large majority of women looking for jobs has a bachelor degree or higher, at 70 percent of unemployed women, it can be clear there is much to gain from the inclusion of women (Yusuf 104). To combat the near impossibility to find jobs for female graduates,

the Saudi government has specified that a third of all government employees are to be female by 2010 (Qureshi 150).

For all investments made in education women gain more benefit than men, since most school going kids and students are female as of around 2005 (Yusuf 103). As a result the massive investments made in education have dramatically decreased female illiteracy. In 1997 girls between the ages of 15 to 24 had a literacy rate of 81%, with the female population of 15 years and older at 57%. In 2015, these rates have increased to 98% and 85% respectively.

Not only education has had a positive effect on women participation. The Saudisation initiative has helped increase employment chances for women quite drastically as well, and continues to help aid the gradual progress towards female participation. For one, deporting illegal migrant workers has ameliorated the “imbalanced and uncontrolled labor market.” (Qureshi 150), and closing down small businesses not abiding the Saudisation quota created new business opportunities for men as well as women to take over the market share of closed down companies.

General development towards a more emancipated job market has been mostly positive for Saudi women. There are still many hurdles to be taken though. Even although the share of female students is similar to males, the same cannot be said for grants for studying abroad. Only around 30 percent of government grants in the aforementioned King Abdullah overseas scholarship program, catered towards studies needed in the developing private sector, are female (Al-Asfour 250). Al-Asfour draws on past experience in Qatar in his observations towards how Saudisation can create opportunities for Saudi female workers. In Qatar, an increase in female participation in the workforce caused a social backlash where social and family problems led to a sharp increase in divorce rates. Whereas this development can be troubling, it does not mean the increased welfare rates

and economic opportunities for Saudi Arabia that can be gained by having women more economically engaged can be simply disregarded. Women should even be able to play a role in the aforementioned opportunities for new entrepreneurship. Yusuf proposes targeted training for female students to increase their willingness to become entrepreneurs. There are however still strong religious and social traditions keeping many young Saudi women from entering into the private sector on their own accord. While the government has made real progress towards this goal, at this point traditions stand in the way of potential female entrepreneurs. The private sector will, as has been hinted at previously, be the most important aspect of Saudi economic development, and will therefore be the focus of the next chapter.

## 3 Private sector development

### 3.1 The Saudi Private Sector

This chapter will deal extensively with the role of the private sector in Saudi Arabia. Private sector development has been mentioned numerous times as being important in creating sustainable economic growth. At this time though the vast majority of government funds flow from the oil sector, which also accounts for the lion's share of the GDP. Eventually the oil sector would have to become less key in the Kingdom's economy. As previously mentioned the Rentier economy is no longer feasible due to falling oil revenue and the growing population. The guarantees for jobs in the governmental sector for all Saudis leads to growing unemployment and stalling economic growth. Before going in greater detail as to why the private sector is important for economic development, it is key to know what the Saudi private sector looks like.

Since 1980, the Saudi economy had been dominated by oil production and export. With fluctuations in the oil price the rest of the economy fluctuated greatly as well. Construction and real estate are examples of sectors that are influenced greatly by the oil sector. As when investments are made in oil production, construction companies and land owners will profit. Hodsden confirms this expectation, as fluctuations in the oil price correlate strongly with booms in construction and real estate sectors compared to the total non-oil economy (124). During the oil boom in the 1970s public spending led to a growth in the private sector, which remained a driving force behind many non-oil sectors. This correlation between public spending and private sector growth has diminished to a large extent from the 1990s (Hodsden 127).

Aside from non-oil manufacturing, which has steadily increased both in total revenue as well as relative to the total Saudi economy, even construction has lost the strong



connection to oil revenues. Hodsen draws the conclusion that from the 1990s the private sector, or at least the non-oil sector has grown to be less dependent on oil revenue and government investment (127). A different way Hodsen recognises this trend is in the fact that Saudi Arabia has fairly low import and export tariffs. For manufacturing industries, especially when producing for the domestic market, having foreign competitors behind an import tariff wall can be very helpful. Protection from foreign competitors allows an industry to be less efficient than when the domestic market would be open. The lack of a tariff wall in Saudi Arabia is a sign of relative independence from government intervention. The fact that there still is a domestic production sector means that it is one of the more competitive ones in the region. Especially since many states like Morocco and Egypt do impose import tariffs.

Some examples of existing private sector industries that play a role in the Saudi economy are in the manufacturing sector: production, assembly and packaging of domestically produced or imported goods for consumption on the domestic market is the main focus of this sector (Khorseed 149). In the eastern province, an area that is also quite rich in oil producing and petrochemical industries also boasts many lighter manufacturing plants. Similarly, many industries are focussing on the processing of foodstuffs for domestic demand. Riyadh not only has some of these light manufactories, but also has some ICT and healthcare industry (Khorseed 149). These sectors could help to develop the economy faster by increasing the usage of potential in the economy, thereby increasing economic output, as it helps increase efficiency for other companies (Yusuf 101). In order to achieve a higher level of implementation of new technologies Khorseed also acknowledges the need for more fitting educational system. Although the gains made that have been described previously, the relative lack of engineers and scientists hinders innovation.

In the hopes of innovating and of increasing efficiency in the economy, the Saudi state has been trying to diversify the economy and to privatise more sectors. As private sector corporations have greater incentive to be efficient, development in the private sector is seen as direly needed (Hodson 131). Sectors like finance and telecommunications have seen privatisation of state companies. What is more, aside from the occasional privatisation of companies, many private businesses have received licences to operate on sectors previously only operated by the state. These include sectors like healthcare, transport, and education.

Saudi private sector employment is very limited compared to government employment. There is however an increasing reliance on private companies. Because of falling oil prices and a quickly growing population the state is no longer able to maintain the guarantees for jobs in governmental positions, leading to high levels of unemployment. Recently, the developing private sector has been increasingly able to withstand fluctuations in oil production. Several measures have attempted to further decrease dependence on oil sales. Investments in human resources, diversification and privatisation are examples of these measures.

### **3.2 Importance of the Private Sector for Economic Development**

Hodsen concludes his article in a similar way Luciani and Hertog have done in that he sees the business leadership to be a driving force towards economic reforms, with a smaller role for state affairs in general economic activity. Given that normally businesses work more efficiently than the state, economic diversification is seen very favourably in the efforts to work towards an economy capable of continued growth. Economic growth is needed in order to keep Saudi Arabia's population employed in the future. Drops in oil

prices like in the 1990's were massively harmful for the Saudi economy. In order to be less vulnerable to price shocks like that, having the population employed in different industries than the public sector can be helpful. Also the diversification of exports is a goal for Saudi policy makers. As of 2008 however, of total exports only about 10 percent have been non-hydrocarbon exports. Of this share about 60 percent is made up of petrochemical products like fertilizer or industrial chemicals (Espinoza 20). The petrochemical sector is a poor substitute when attempting to combat the vulnerability for price drops of oil, being so closely linked to the oil producing industry.

Apart from this vulnerability to price shocks, exporting large amounts of goods creates a situation that is particularly harmful for exporting industries. This so called Dutch disease is a situation where large exports and little imports cause an appreciation of the own currency. The relatively high price of the own currency in turn hinders other exporting sectors by increasing the prices of Saudi products in other countries (Oxford dictionary of economics). Saudi Arabia maintains a fixed exchange rate to the dollar, as the dollar is the primary currency in trading in oil and petrochemicals. Pegging the exchange rate allows for easier trading of oil products. Combined with the effects of the Dutch disease it causes large overvaluation of the currency, where the equilibrium price of the Riyal would be much higher than the maintained price (Kandil 5982). This in turn interrupts other exporting sectors as well as it is the primary cause for high inflation (Kandil 5984). As a result export-led growth is much more difficult to achieve for the Saudi economy than when oil exports would be lower. Diversification of the economy is however very important. In order to boast long term economic growth, as well as stabilising the rate of growth over time the Saudi economy should not only be dependent on the hydrocarbon industry (Albassam 113).

Aside from economic growth, social development and political stability will also benefit from a more diverse economy (Albassam 113). Since the onset of the oil boom in 1970 has Saudi administration started formulating five year development plans. However even although the development plans have been setting goals towards achieving diversification, not much progress has been made to this end. Albassam states that although goals were set, there was a visible lack of commitment from the Saudi government to achieve these as there were no clear steps described in the development plans. Examples in other countries have been clear in that diversification led to higher economic growth as well as more political stability. This leads to the conclusion that attempting to stimulate private sector diversification should be key in economic reform programmes. A private sector that is not dependent on government spending or investment has led to growing national wealth in similar economies (Albassam 117). The Saudis should however not view the stimulation of the private sector as only a way to increase economic growth as it has also helped diminish corruption and increase the efficiency of bureaucratic institutions (Albassam 116).

In short the private sector in the Kingdom has been underdeveloped. Investing in the creation of an independent and sizeable private industrial sector is inhibited by the export of oil. Overreliance on the oil export has more drawbacks, since it renders the economy vulnerable to external economic shocks. Since oil prices have been dropping the Saudi government has put new focus on the development and diversification of the private sector.

### 3.3 Agriculture and Investments

With regards to diversification, agriculture has been one of the sectors where on which development plans have been particularly focussed. In the period following 1980 this practice was started with the underlying goal to become completely self sufficient with the production of many foodstuffs. Saudi farmers, mostly without knowledge of settled farming, were given large subsidies to import knowledge, equipment and anything they would need to set up an agricultural sector (Elhadj 1). In the following years this investment led to an enormous increase in especially wheat production. In the 1990s the gulf wars and the following oil crisis put a large enough strain on the Saudi budget that this practice was admitted to be impossible to maintain: Elhadj estimates the costs of producing a ton of Saudi wheat to have been ten times the price of wheat per ton on the world market (3). This example is however less about the failed experiment as it also symbolises what is wrong with Saudi public investment. The wheat program was not set up to aid average farmers. Much of the subsidised land was in the hands of very few large land owners (Jones 232). These land owners were primarily members of the royal family who benefited greatly from the subsidies, leading to the perception that they were not meant to increase food independence, but rather to buy political support (Jones 233). When the subsidies were stopped in 2008 it was clear that the agricultural efforts did not lead to possibilities for diversifying the Saudi economy, rather the government subsidies flowed into large companies involved in state affairs (Albassam 114)

Whereas diversification is a way to make the economy a more stable one for future situations, the driving force behind actual growth is investment. Investing in new or existing companies creates economic opportunity for scale enlargement or for increases in efficiency. Like mentioned before, technological advancements are very important in the theory behind economic development. This is one of the reasons the Saudi government has

been investing so much of its spending in the education system. However, without investment new high tech companies will not be able to sprout from acquired knowledge, nor will existing industries be able to make use of new technology. Looney mentions that investments have been relatively high in the Kingdom, but that they have not been able to have the expected result (1).

The reforms passed in the Saudisation program have created stronger links between investments and growth. Saudisation has had a negative side-effect as well in that uncertainty around the employment of non-nationals has kept foreign investors from doing business in Saudi Arabia (Looney 5). Seen as foreign investment is not only a way to increase total investments but also to exploit foreign knowledge the Saudi administration has pushed through reforms for foreign entrepreneurs. Not only was the corporate tax rate for foreign investments cut in half from 45 to 20 percent (Looney 5), the list of sectors where full foreign ownership is forbidden has been cut down.

### **3.4 Reducing Public Sector Influence**

As has been exemplified by the wheat farming experiment, governmental subsidies have not worked towards the diversification of the economy or the strengthening of the private sector. Industrial subsidies have not only failed to do these things as well, but have also had other negative effects including wasting resources and reducing incentive for innovation (Espinoza 72). In the justification for many of the established subsidies there is mention of a so called spillover effect, where money flowing from the state into an industry, acts as a way to increase profits and therewith increasing welfare. However, as Espinoza argues, since many of the subsidies go directly into the hands of large government owned companies, there is little actual spillover (73). Having established this,

and seen as public sector employment has had many ill effects on economic growth, the final question would be how the role of the public sector can be reduced in the Saudi economy. Several options have been mentioned before. For one the educational sector is a powerful tool in the attempt to forge an independent and strong private sector. It is normal for students from higher education to have serious trouble finding jobs with the skill set they acquired during their studies. Many of the students that can be employed directly after graduation have taken extra courses. Private companies as well as higher education institutions should therefore have the knowledge of what changes can be made in the curriculum for better job prospects, which can in turn decrease the unwillingness for working in the private sector (Yusuf 100). Additionally, ICT investments can increase productiveness of the labour force, also stimulating private activity.

Saudisation, although being rather disruptive for established companies can also help create opportunities towards lesser reliance on public spending, since the money that flows out of the Saudi economy in the form of remittances would instead flow into the local population, leading to increased spending and therewith opportunities for non-state led growth of the private sector (Espinoza 45). On the same note can economic diversification increase the money supply in the hands of potential investors, possibly leading to a snowball effect. As for what the government can do in this area has Yusuf put forward the proposition that women should be less held down by legal or cultural limitations in establishing companies of their own. She states a number of possible ways in which this cultural problem can be solved. Encouraging a first wave of female entrepreneurs to open up businesses can help break the cultural problems surrounding female employment. This can be done for example by offering internships or educational courses (103). Through these measures can public sector importance be increased.

## Conclusion

All in all, the Saudi economy is very strongly linked to the government. As has become clear through many of the examined aspects of the Saudi Economy explored in the Rentier State Theory, the need for some kind of reform program is high. As of late the government has no longer been able to support the same number of people through direct employment. At the same time there is a large number of Saudis unemployed and there are many expatriate workers on the labour market. Several kinds of measures are taken to the end of diminishing the dependence on foreign workers, but the focus should lie on those measures that can bolster structural improvement in the compatibility between the Saudi workforce and private sector jobs. Saudisation is therefore a less desirable program than investments in human resources.

Linkages between government and many of the largest companies mean that much of the money spent in subsidies flows back into the state without benefit for the economy. Many of the reforms are in an effort towards creating an economic system that is less focussed on state intervention. It has become clear that there will have to be several societal changes as well. Labour in the Kingdom is, despite the extensive spending in education, still not compatible with the needs of the Saudi economy.

The government's focus should for economic growth and employment lie more in private sector companies. Economic diversification and the development of the high tech sector are the most promising directions the Saudi economy can take. Foreign investors can help supply funds and knowledge to the Saudis.

To conclude, with regards to economic development there are several things that should and should not be done or attempted. At present, there is however only one major player in the process of reforming the economy, and that is the state. The question to what extent the Saudi government is influential in development can only be answered in one



way: it is crucial for any change in Saudi economic and societal structures. The state supplies the majority of its citizens with jobs and leads a great part of the economical activity. Therefore the initiative towards new and sustained economic development lies with the Kingdom's leaders, but the only option lies in diminishing their share in it in the future.

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