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AN EVALUATION OF SAUDI ARABIA'S POLICIES  
FOR ECONOMIC DIVERSIFICATION

Christine S. McNulty

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Thesis submitted for the Degree of Master of Arts in the University of  
Durham.

June 1984



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Thesis  
1984/MAC

To my parents.

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Abstract

The aim of this thesis is to evaluate Saudi Arabia's policies for diversification. Economic diversification only became a realistic possibility following the first major oil price rise in the early 1970's. Not surprisingly the immediate reaction was to follow the example of western industrialised countries, and consequently very ambitious plans were discussed. This over reaction was soon rationalised. The Second Development Plan covering the 1975-1980 period, laid the foundations for diversifying the economy by providing for the creation of a much needed infrastructure. It was left to the Third Development Plan covering the 1980-1985 period, to define a selective approach to industrialisation so that only the economically feasible projects remained.

It is rather too early to assess just how successful the Third Plan has been. The most that can fairly be asked is: has the Government begun to implement its policies for economic diversification? The abrupt change in revenues almost forced the Government to rely on imports for development if it wished to take immediate action because of its limited domestic economy. Consequently, industrialisation in Saudi Arabia is largely dependent on imports, and most diversification amounts to the implementation of import substitution policies. Export diversification is virtually the export of any goods or services other than oil. It is thus essential to analyse the determinants of imports and exports and to look at recent trends.

## Foreword

The image of Saudi Arabia is sometimes one of romance with sheikhs spending millions of pounds on diamonds or other whims of fancy, rather than the more realistic one of economic planners making careful, rational decisions. The Saudi Arabian Government has drawn up three development plans to date: the First Plan 1970-1975, the Second Plan 1975-1980 and the Third Plan 1980-1985. Each is based on well thought out economic objectives, pushing or pulling the economy in a specific direction. One of the general aims of this thesis is simply to show that Saudi Arabia has a sensible development strategy. It should provide an insight into some of the decisions taken, which have been dictated by the country's economic environment. In particular, this thesis attempts to evaluate Saudi Arabia's policies for economic diversification.

Economic diversification only became a realistic possibility after the well-documented price increase of oil in 1973-1974. It was only at this time, at least in the short term, that financial constraints were removed. The growing economy required careful monitoring and planning, especially as the Government wished to ensure that Saudi culture remained intact, points looked at in the first introductory chapter.

The Government wished the economy and its people to immediately benefit from these revenues but the limited, existing domestic economy made it essential to make use of imports. Imports then acted as the so-called, engine of growth for development; the demand for imports increased and the economy soon became dependent on imports in order to sustain growth. Questions such as whether imports are primarily for current consumption or

if they are contributing to future development we analysed in chapter 2. The determinants of imports are examined using formal linear regression analysis as these determinants are also likely to be crucial for import substitution and hence economic diversification. Regressions have not been attempted before using Saudi data. Chapter 3 on import substitution presents hitherto unused material as the tables were compiled using unpublished industrial survey data. With this major exception it was mainly necessary to use secondary sources, although primary data from the Saudi Arabian Monetary Agency and the Ministry of Planning were also used.

Saudi Arabia has little industrial tradition. It was thus a necessity to use expatriate workers to implement these import substitution policies. As chapter 4 shows, a number of problems surround this. Without doubt the use of expatriate labour has a high opportunity cost politically, socially and economically. Another problem is that the natural depletable resource, oil, is almost the only foreign exchange earner. In Saudi Arabia there is an evident need for export diversification. The country aims to exploit its comparative advantage. Consequently, export diversification is largely based on the use of oil or gas as major inputs.

The evaluation of economic diversification policies in Saudi Arabia involves the observation of the country's external relations. Without imports, industrialisation cannot take place and oil revenues fund these imports. Import substitution policies and export diversification policies must go hand in hand. The economic base must be developed first to pave the way for export diversification policies. The last chapter thus looks at the implications of economic diversification for the Balance of Payments.

## CHAPTER 1

### INTRODUCTION: PROBLEMS AND POTENTIAL

#### 1.1 THE PROBLEM OF OVERDEPENDENCE

Saudi Arabia is a single-commodity economy. As will become apparent, the dominance of oil in the country's foreign exchange earnings, government revenue and as a source of growth of national income is the most obvious characteristic of the economic system. However, the oil sector is not an important source of employment.<sup>1</sup>

Before 1970 Saudi Arabia oil revenues were only a fraction of their post 1970 dimensions. Indeed at the end of the 1960's so little had the focus of the Saudi Arabian economy moved towards oil that the annual pilgrimage to Mecca (hajj) remained a significant source of government income and employment for the local population. The high prestige of employment based on the hajj and the periodic return of this work remains an influence on the employment patterns of Saudi Arabian nationals even today. The natural conservatism of Saudi Arabia's leaders meant that modern development proceeded cautiously: there was protracted debate about the impact of modernity upon moral values. This can be illustrated by the large proportion still working in the (rather ill-defined) sector, 'agriculture and nomadism'. In 1970 virtually one half of the Saudi Arabian economically active labour force, was still in this sector. At this time the 'agriculture and nomadism' sector was traditional in



organisation and its technology was largely that of subsistence hill farming.

This was in sharp contrast to the oil industry. The low levels of educational attainment and limited modern sector employment experience of Saudi nationals meant few opportunities for them to work in the oil sector. The various arms of government and public administration represented the principal alternative to farming for most Saudi Arabians - thus in 1970 their employment options were very much the same as they had been for the past century. Terms of service and conditions in the police, army and civil service did improve. Yet, many Saudi Arabians of urban background continued to follow private trading pursuits, as this existence suited their attitude and expectations of life. Ironically, the concern of the time, despite the limited impact of modernity, was that change was proceeding too rapidly.<sup>2</sup>

In Saudi Arabia today, the concern is centred on the need to diversify the economic base of the economy. There is a problem of overdependence on the oil industry, as becomes clear from the figures on the distribution of gross domestic product (GDP) according to economic activities. This analysis can be observed in two ways: at a point in time and, from a dynamic view by looking at the way the shares of various economic activities have been behaving over time. The latter approach will first be adopted.

During the thirteen year period from 1965 to 1978 there were significant structural changes in the economy of Saudi Arabia so far as industrial origin of the GDP was concerned. There is a sharp contrast in

the composition of economic activity between 1965 and 1978, as table 1.1 shows. Firstly, there was a relative shift to crude petroleum and gas whose share of GDP peaked in 1974 and declined through the rest of the decade. The dramatic price rise for oil in 1973-74 resulted in significant reductions in the relative contributions of all non-oil activities in the economy in favour of crude oil and gas production. Secondly, some sectors of the economy achieved increased shares: construction 5.5 to 14.3 per cent; government services 3.6 to 6.8 per cent; and transport, storage and communications 1.7 to 4.5 per cent. This is in terms of current prices but the situation is different when viewed at constant prices, that is, in terms of real GDP.

In terms of constant prices, the structural shift appears to be less prominent as might be expected when the significant rate of inflation has been accounted for. The table shows that the following activities all increased their shares of real GDP between 1965 and 1978: "other manufacturing", construction, commerce, restaurants and hotels, services and, other minerals. This occurred not only at the expense of crude oil and natural gas production, but also at the cost of reduced shares of other non-oil activities, such as, agriculture and government services. Over the thirteen year period it appears that the structure of the economy of Saudi Arabia in general shifted in favour of crude oil and gas production and construction. There was movement away from important sectors such as agriculture. In short, it appears that crude oil and natural gas production generated 56.4 per cent of GDP at factor cost (current prices) in Saudi Arabia in 1978. At constant prices this sector's share is reduced to 46.9 per cent. It is very unlikely that the next five years will show

Table 1.1

## Saudi Arabia's Gross Domestic Product by Economic Activity (per cent)

Type of economic activity	Current prices				Constant prices			
	1965	1975 <sup>a</sup>	1976 <sup>a</sup>	1978 <sup>b</sup>	1965	1975 <sup>a</sup>	1976 <sup>a</sup>	1978 <sup>b</sup>
Agriculture, forestry and fishing	8.5	1.0	0.9	1.0	8.3	3.7	3.5	3.2
Mining and quarrying:	44.2	75.2	66.9	56.9	44.2	54.9	51.1	47.3
Crude petroleum and natural gas	44.0	75.0	66.6	56.4	43.9	54.6	50.8	46.9
Other minerals	0.2	0.2	0.3	0.5	0.3	0.3	0.3	0.4
Manufacturing:	8.3	5.2	4.9	4.4	8.0	6.3	6.2	6.4
Petroleum refining	6.4	4.1	3.6	2.6	6.2	4.1	3.8	3.8
Other manufacturing	1.9	1.1	1.3	1.8	1.8	2.3	2.4	2.6
Electricity, gas and water	1.3	0.1	0.1	0.1	1.1	1.0	1.0	1.3
Construction	4.9	5.5	9.6	14.3	5.2	7.8	9.6	10.9
Commerce, restaurants and hotels	7.0	2.8	3.8	4.9	7.1	6.0	6.8	8.5
Transport, storage and communications	7.2	1.7	2.5	4.5	6.9	4.1	4.6	5.6
Services:	4.8	3.9	5.1	5.7	4.8	7.0	7.6	8.3
Ownership of dwellings	4.2	2.5	3.2	3.4	4.2	5.2	5.6	6.1
Other <sup>c</sup>	0.6	1.4	1.9	2.3	0.6	1.8	2.0	2.2
Community services	5.5	0.9	1.2	1.5	5.7	1.0	1.1	1.1
Less bank charges		-0.2	-0.3	-0.7		-0.2	-0.2	-0.3
Subtotal (GDP) of population	91.7	96.1	94.7	92.6	91.3	91.7	91.4	92.3
Government services	8.3	3.9	5.3	7.4	8.7	8.3	8.5	7.7
GDP in a factor cost	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: a. Revised estimates. b. Preliminary estimates. c. Less imputed bank service charges.

Source: Computed from SAMA, Statistical Summary, 1st issue (Riyadh, 1977), Tables 27 and 28, and 2nd issue (1977), Tables 28 and 29; SAMA, Annual Report (1977), Tables 28 and 29, pp. 146-9 and (1979), Tables 19 and 30, pp. 165-8.

Source: El Mallekh, R. Saudi Arabia: Rush to Development, p. 29.

the same upward trend. The desire now is to follow policies which restrict production and encourage the diversification of the economy.

Turning to expenditure patterns depicted in table 1.2, it is possible to discover how much private consumption, government consumption, capital formation and foreign accumulation of savings have been taking place. The share of government consumption has increased quite consistently over the last decade. This can be explained by the desire of the Saudi Government to share the wealth generated by oil with the whole population via mechanisms of subsidies, provision of social services and increased state sector employment. That is, private consumption is not an adequate measure of the economic welfare of the population. The situation in Saudi Arabia is different to that existing in the west: private consumption to a large extent depends on government consumption. Private consumption and government consumption are complementary and the problem of the 'crowding out effect', whereby private consumption is squeezed, does not arise to any great extent in Saudi Arabia. In other words, one does not take place at the expense of the other, a point looked at in more detail in the next chapter.

Between 1971 and 1978 the economy performed remarkably well by growing at an annual rate of 26.7 per cent. The expansion lies in increased oil revenues although the years 1970 to 1975 saw an acceleration in the rate of inflation. The real rate of growth of GDP is much lower than the nominal rate, that is, 14.1 per cent. In so far as consumption per capita may be regarded as a measure of how well off the Saudi population is becoming, the average citizen seems to be enjoying a steadily improving standard of

Table 1.2a

Gross Domestic Product of Saudi Arabia by Expenditure Categories, 1963-70 (SR (Saudi riyal) millions)

	1963	1964	1965	1966	1967	1968	1969	1970
Consumption expenditures								
Private	2,742	2,835	2,910	3,026	3,177	4,585	5,360	5,859
Government	<u>1,244</u>	<u>1,430</u>	<u>1,654</u>	<u>1,915</u>	<u>2,437</u>	<u>2,747</u>	<u>3,026</u>	<u>3,421</u>
	3,986	4,265	4,564	4,941	5,614	7,332	8,386	9,280
Gross capital formation	1,076	1,094	1,499	1,987	2,418	3,127	3,354	2,806
Net foreign sector	3,611	3,961	4,341	5,011	5,196	4,197	4,235	5,312
Expenditure on GDP	8,673	9,320	10,404	11,939	13,228	14,656	15,975	17,398

Table 1.2b

Gross Domestic Product of Saudi Arabia by Expenditure Categories, 1971-8 (SR millions)

	1971	1972	1973	1974	1975a	1976a	1977a	1978b
Consumption expenditures								
Private	6,412	6,914	7,896	9,827	17,897	12,738	34,148	50,995
Government	<u>3,798</u>	<u>4,285</u>	<u>5,335</u>	<u>9,864</u>	<u>15,911</u>	<u>28,883</u>	<u>41,033</u>	<u>47,034</u>
	10,210	11,199	13,231	19,691	33,808	52,621	75,181	98,029
Gross capital formation	2,272	2,498	5,694	8,400	17,841	33,705	51,416	67,136
Net foreign sector	9,984	13,559	21,740	70,389	87,204	77,421	77,622	57,688
Expenditure on GDP	22,921	28,256	40,552	99,315	139,600	164,526	205,056	223,747

Notes: a. Revised estimates. b. Preliminary estimates.

Sources: SAMA, Statistical Summary (December 1970), Table 25 and 2nd issue (1977), Table 30, SAMA, Annual Reports 1977, Table 30, p. 150 and 1979, Table 31, p. 169

Source: El Mallekh, R. Saudi Arabia: Rush to Development, p. 31

living. Since 1964 per capita private consumption has been rising at an annual rate of at least 8 per cent. However, real private consumption per capita provides a rate of growth of welfare of 4.2 per cent between 1964 and 1978 and only 0.6 per cent between 1970 and 1978. It is suggested that this low rate is compensated by the very high rate which the country added to its capital stock. Gross capital formation grew at a rate of 52.1 per cent between 1970 and 1978 due to the increased oil revenues after 1972 and the emphasis placed on infrastructural construction.<sup>3</sup>

The important position of imports in the Saudi economy in some ways reflects the dynamic processes of development which the economy is currently experiencing. The total value of imports rose approximately thirty times between 1960 and 1978. Between 1968 and 1978 total imports have grown from SR 2,578 million to SR 69,180 million. The largest increases have occurred since 1973. The average annual growth percentage between 1973 and 1978 is 58.2 per cent including the 1976 figure of 107.0 per cent and 1978 figure of 33.9 per cent. Of course the sharp rise in the value of imports for these years may be attributed in part to the inflationary trends. Still, a substantial part must represent satisfaction of the development requirement for the First and Second Development Plans (1970/75 and 1975/80 respectively) as well as an increase in the marginal propensity to import of the private sector. Because imports are crucial to the development and economy of Saudi Arabia, both chapters 2 and 3 are devoted to a discussion of their role.

Saudi Arabia's emergence as a political and economic entity in the last three decades has taken place under conditions without parallel among

developing nations. It is suggested that if the analysis of the Kingdom's evolution were integrated into the main body of political development theories, many changes would result. In short, the Saudi experience is often ignored and "theories" are often generalisations. Braibanti and Al Farsy put forward six conditions which set the Saudi experience apart - and these conditions are wide ranging.

Firstly, the Saudi cultural, religious, linguistic and ethnic cohesion is unparalleled, although confronted by the use of resident foreign manpower. The Kingdom is the only major nation whose constitution is sacred scripture, the Holy Qu'ran. Secondly, its political system does not embrace such institutions as political parties and legislatures. Thirdly, quite a successful effort has been made to control the admission of non Saudi values on policy. Fourthly, development is taking place in the context of affluence rather than abject poverty and so creating an unusual national psychology. Fifthly, there has been a different sequence of development with institutional infrastructure being built before mass participation of Saudis in their economy. Finally, the policy has evolved in less than half a century and has been unimpeded by a colonial tradition, unlike Africa and Latin America for example. Therefore, these combined conditions make Saudi Arabia distinct from the majority of Third World Nations.<sup>5</sup>

## 1.2 REMOVAL OF FINANCIAL CONSTRAINTS

"The escalation of oil prices, particularly in the mid 1970's, played a major role in lifting Saudi Arabia - almost overnight -

Table 1.3

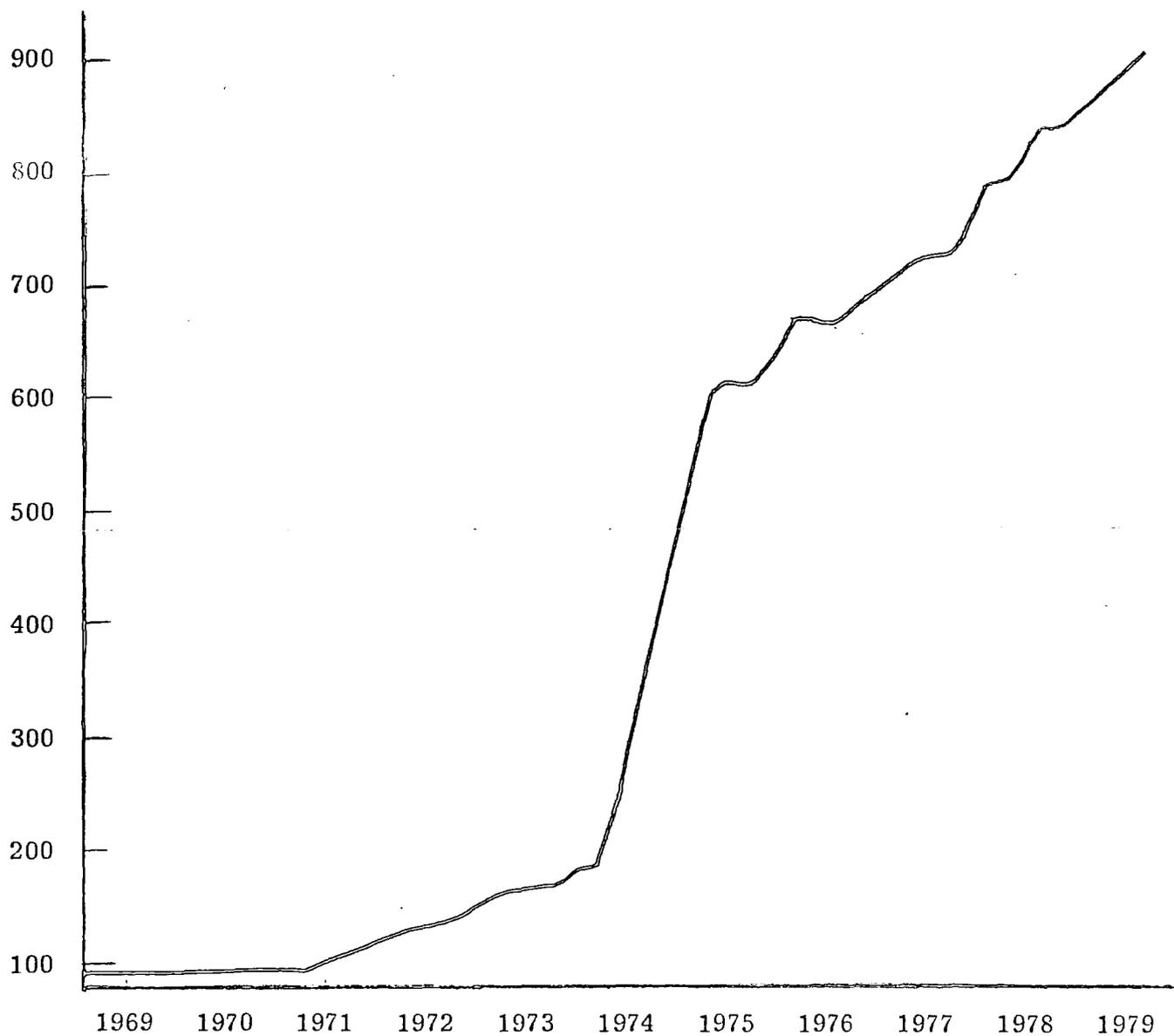
Revenue from the Export of Petroleum and Production

	Revenue from the export of Petroleum (Billions of Riyals)	Crude Petroleum <sup>1</sup> Production
1970	9.89	34.8
1971	14.92	45.3
1972	18.82	58.9
1973	28.93	75.8
1974	110.54	85.6
1975	104.54	71.3
1976	136.91	87.0
1977	154.98	93.0
1978	128.56	83.2
1979	197.12	95.3
1980	339.37	100.0
1981	383.00	97.5
1982	259.93	61.0

1 1980 = 100

Source: IMF International Financial Statistics, Yearbook 1983, pp. 438-439.

Table 1.4  
Indexation of the Price of Saudi Arabian Crude Oil  
(1969 = 100)



Source: IMF Bureau of Statistics, International Financial Statistics  
November, 1979.

The Government is well aware of the problem and, as will be shown in section 1.3, it is attempting to use the oil income wisely. Although Saudi Arabia has a less acute problem concerning finance than most developing countries, the Government still has to act within given financial constraints. It too is looking for the optimum utilisation of resources. Efforts have been made to develop downstream petroleum products that use crude oil as a major input. At the same time, the Government accepts that some day the oil will be depleted (or in the future there may be insufficient demand for its oil). Consequently, efforts are now being directed to the development of non-petroleum based industries.<sup>7</sup>

Many factors allowed Saudi Arabia to increase the revenue it received from oil. No attempt will be made to provide a comprehensive account of all factors involved, within this single section. Nonetheless, it will provide an outline of some of the more evident factors involved in the last two decades. Firstly, the formation of OPEC. As many are aware, OPEC was established in September 1960 as a direct response to the challenge posed by the multinational oil companies in unilaterally reducing the posted prices of crude oil in February 1959 and in August 1960. Shortly after its foundation the organisation began an in-depth study of oil prices to determine a fair pricing formula, supported by a study of international pro-rationing. By June 1968 the Declaratory Statement of Petroleum Policy in part recommended that posted prices (that is, the tax reference price) ought to be determined by the government so that it was consistent with the prices of manufactured goods which enter into international trade.

Also by 1970, a 'seller's market' had emerged due to the increased consumption by the Western industrialised countries. This factor, coupled with factors like the closure of the Suez Canal between 1967 and 1974, encouraged the producing countries to enter into negotiations with the major oil companies. One of the aims of the 1970 Caracas, Venezuela meeting was to establish a uniform, general increase in the posted prices in all member countries at OPEC. This conference resulted in the February 1971 Teheran Agreement which provided for long sought financial rewards, reflecting the conditions in the global petroleum market. A further objective of OPEC was to protect the price of oil against potentially damaging fluctuations of exchange rates. This objective was fulfilled by the January 1972 Geneva Agreement. Together these Agreements protected Saudi Arabia from imported inflation and price changes that precipitated the balance of payments crisis in the late 1950's. OPEC is thus a significant factor in Saudi Arabia's achievement of increased revenues.

In Saudi Arabia, government income from the oil sector consists of 1) oil royalties from operating companies, 2) income tax collected from these companies, 3) to a much lesser extent, an oil-product tax which is levied on consumption of locally produced or imported oil products, 4) tapline fees and, 5) payments received by the government in respect of the 60 per cent participation interest in ARAMCO's production facilities. With this in mind, it is now possible to look at the specific affects of the agreements on Saudi revenues. For example, between 1970 and 1972 exports increased by 29 per cent from 1,722.1 million barrels to 2, 195.2 million barrels. This was accompanied by a rise in the posted prices leading to a rise of 43 per cent in the value of exports of crude oil and refined

products, from \$3,838.8 million in 1971 to \$5,491.5 million in 1972. In fact, as a result of the combined effects of sharp increases in production, exports and changes in posted prices and tax rates, the revenue from oil more than doubled in a period of only two years, from \$1,214 million in 1970 to \$2,744.5 million in 1982.

Despite the achievement of vast increases in oil revenues in the last decade, Saudi Arabia's image and actions are those of a "moderator". This is partly because the Government is trying to find a combination of oil production levels and oil price levels to satisfy all the competing internal and external forces. That is, from Saudi's requiring a high price level and low production and from consuming countries, especially Third World countries suggesting the price is too high.<sup>8</sup> Perhaps the December 1976 OPEC Conference convened in Doha, Qatar provides a good example of the moderating influence of Saudi Arabia on other oil endowed states. At this Conference, the majority of members supported a 10 per cent price increase as of January 1977, to be followed by a further rise of 5 per cent in July of that year. Saudi Arabia, as well as the United Arab Emirates, successfully pushed for the effective establishment of a two tier pricing system within OPEC. This instance and the unanimity of price increases in the past was due overwhelmingly to the strong position of Saudi Arabia. The country has massive petroleum reserves believed to be in excess of 177.5 billion barrels and a 'cushion' of surplus funds allowing a relatively wide range of output fluctuations. These massive reserves certainly play a part in allowing Saudi Arabia to act as a price moderator. Saudi Arabia's actions could be regarded as 'limit pricing'. If the price of petroleum rose too quickly, the west would turn increasingly to

non-oil substitutes (although it is argued that this has already happened). This would mean that in the long run Saudi Arabia might be left with large unsold reserves. By keeping the price at a 'reasonable' level, or moderate level, oil consumption levels are sustained.

Also, Saudi Arabia's decision to provide lower price petroleum reflects her view of the international economy. In 1977 Saudi Arabia considered the imported inflation rate too high and the world's economic recovery was considered insufficient to absorb or manage a 10 per cent oil price rise. Furthermore, the Saudi's saw their moderation as an incentive to the industrialised consumer nations to deal with Third World problems in a constructive and affirmative manner. Saudi policy also represented the desire to involve the United States in resolving the Middle Eastern political conflict and in bringing peace to the region.<sup>9</sup>

### 1.3 NEED FOR PLANNING

It is hoped that 1.2 has made the reader aware that, unlike most developing countries, in the mid 1970's Saudi Arabia was in a position whereby, there were no financial constraints on the economy's expansion. In fact, revenues exceeded the budgetary requirements of the existing Second Development Plan. The First Plan covered 1970-75, the Second Plan 1975-80 and the Third Plan was launched in 1980. For the most part, the first two plans have been implemented successfully. For example, between 1970 and 1975 GDP grew 3.7 per cent above target. This brought the growth of GDP at constant prices to the rate of 13.5 per cent. Between 1975 and 1980 growth in the GDP was around 8 per cent, somewhat below the projected

rate of approximately 10 per cent. However, the level of productivity is somewhat uncertain due to the large expenditures made during the 1970's as a result of the effective removal of financial constraints. Actual expenditure was almost 200 per cent more than planned expenditures in the First Plan. Both the Second and Third Plans were thus conceived at a time when, for all practical purposes, no financial limitations existed. The Second programme was almost nine times larger than the First in terms of total planned expenditures (in 1974 to 1975 constant prices); the Third Plan was 50 per cent larger than the Second.

The structural features of the three plans have differed. The primary purpose of the first was to lay down a firm infrastructural foundation for future development. Consequently, physical infrastructure was stressed. As table 1.1 shows, the Second Plan with the virtual elimination of financial constraints, was more ambitious in accelerating the development of physical infrastructure while also allowing for more overall development. The Third Plan signalled a rather dramatic change in that, a consolidation of growth was projected in order to curtail the amount of expatriate labour employed. Also, during the 1980 to 1985 period there has been an emphasis on the need for the development of Saudi manpower and, diversification of the economy. All faced up to the problem of using available resources effectively.

Although Saudi Arabia is exceptional regarding financial limitations, the country has faced many of the problems experienced by other developing countries. In the Saudi case, the main bottlenecks have been inadequate administrative capacity, manpower shortages, and the inability of physical infrastructure to absorb the increased expenditures. Inflation was a major

setback during the Second Plan so that the Government was forced to freeze budgetary appropriations for 1976 to 1977 at the 1975 to 1976 level of SR 110.9 billion. This action abated the high rate of inflation and allowed expenditure appropriations to return to SR 130 billion and SR 160 billion in the final two years of that plan period. However, some economists warn that the higher oil revenues resulting from the 1979 and 1980 price increases could set off another substantial round in the inflationary spiral. According to the official statistics of the Saudi Arabian Monetary Agency, the per annum increase in the cost of living index for 1977 to 1978 was estimated at -1.6 per cent indicating that restrained fiscal policies may allow the country to avoid inflation.

A recent trend has been towards a closer balance between the real and budgeted expenditures of government. The 'gap' had been 21 per cent during the span of the First Plan, however, the Second Plan showed clearly the accelerated rise in absorptive capacity. Actual expenditure exceeded the original appropriations and had to be financed by supplementary allocations during the course of the fiscal years. More significantly, the budget difference between actual and allocated expenditures in each of the first three years of the Second Plan has exceeded the total budgeted outlay of the full five years of the First Plan.

Inadequate labour supply remains a massive problem of the Third Plan. Stated imported labour requirements in the Second Plan to 1980 of 812,600 were so inadequate, that a 60 per cent overrun was recorded in 1979. Unfortunately, the limited response of the indigenous population to meet the labour needs aggravated the problem. The Second Plan attempted, and

now the Third Plan attempts, to upgrade local labour skills through vocational training programmes. The immediate financial rewards available in trade, real estate, and the lower ends of government bureaucracy have tempted Saudis more. Another problem experienced between 1975 and 1980 was the slow implementation of the petrochemical projects, while construction in public infrastructure projects rushed ahead. In the latter case, there was a near saturation of construction in projects such as hospitals, schools and government buildings. Petrochemicals form a vital component in the development schemes of any oil based economy but fortunately, the delay did not result in a major negative impact, in part because the international market in petrochemicals had been depressed.

The Second Plan produced a bigger range approach to planning forcing three major changes. First, the Saudis changed their entire strategy of economic development by deciding to abandon a blunderbuss approach to diversification and instead to focus on developing new industries to maximise resources. The shift in the early 1970's was a result of the Saudis facing up to the fact that over the long run their oil wealth is a wasting asset. The Second Plan contained the assumption that by the year 2000 the Saudis would no longer earn a significant amount of money from exporting fuel oil, although such assumptions have since changed. Second, the Saudis decided to invest enough of their surplus resources abroad to assure that their income from these investments would be able to subsidise Saudi economic growth, after the income from the direct sale of fuel oil declines or disappears.

Finally, the Saudis decided to change their entire modernisation strategy. In the First Plan, where money was a constraint, there was an incredibly ambitious policy of industrial diversification designed to create a miniature United States! The Second Plan marked the realisation that the Saudis would never have enough money and manpower to develop all industries simultaneously. Instead, the Saudis decided to narrow their industrial profile to maximise their natural advantages in oil and minerals. The aim was to develop a diversified oil-based chemical industry so that by 1990 Saudi Arabia would be able to phase in the the export of petrochemical commodities and manufactured products from its oil wealth faster than it phased out the export of fuel oil itself.

The Third Development Plan emphasises the need for diversification of the economy. Stress is placed on the social aspects of development, particularly in labour resources and training. The Saudi economy still lacks sufficient back-up activity and so maintenance in general is, and must be, given prominence. The emphasis on diversification policies mean that the areas of productive and services industries, manufacturing and certain aspects of agriculture are important ones. In general it can be said that the role of the Saudi Government in the development process of the country has essentially been to undertake policies which would diversify the economy and improve the standard of living of the population, without sacrificing the freedom of the individual and the private sector's ability to respond to the government's incentives within a free market system.<sup>10</sup>

In the very long run, planners envisaged that Saudi Arabia would become one of the world's major centres of advanced research and development, subsidised by billions of dollars from Saudi investments abroad. Although it was accepted that the Saudi petrochemical industry would have to be subsidised for many years, the reasoning was that the centre would assure that eventually Saudi industry would be able to thrive in the highly competitive chemical and basic metals industries within 30 years without any subsidies. Another goal which was conceivable only within a time-frame of 20 years or more, was national self-sufficiency in food. Not until the actual budgeting of the Second Plan was finalised in May 1975, did strong priority on expensive water programmes, as an essential part of the agricultural infrastructure, materialise.<sup>11</sup>

#### 1.4 SAUDIZATION OF THE ECONOMY

The guidelines to the Second Plan state that the policy option of rapid progress underpinned by foreign labour poses the threat of undermining religious values and weakening the social structure and of turning Saudis into second-class citizens in their own land. The principal challenge of accelerated economic growth in Saudi Arabia was the danger that Western education and Western influences would destroy the Saudis' understanding of their own culture, that is, of the moral and intellectual values on which their entire society is based. Culture is the formation and refining of the individual's moral and intellectual nature and can be religious in origin. The worry was that the uncultured Saudi would confuse the technological tools of Westernisation with the materialism which tends to accompany the technological modernisation process. That is, the pursuit

of material well-being, might undermine the spiritual well-being of the Saudi people. Therefore, in Saudi Arabia where national survival and spiritual well-being are felt to be one and the same, they are given a higher priority than material well-being.

Planning in Saudi Arabia has shown an awareness of potential problems caused by changing the society from an overwhelmingly rural, to an overwhelmingly urban base. Consistent attempts have been made to ensure that a sense of community, essential to the survival of cultural values, is left intact. A uniquely radical shift in the demographic make up of Saudi Arabia was deemed essential for modernisation and for the maintenance of an equitable income distribution during the modernisation process. In general the government's policies for economic growth are careful not to destroy Islam but rather to contribute to a new Islamic renaissance. The guidelines to the Second Plan provide four major goals to prevent the degeneration and possible destruction of Saudi Arabia: firstly, the need to upgrade the quantity and quality of religious education. The aim here is to harness technology and management to traditional values so that economic and social change will be guided and understood within the context of the Wahhabi doctrine.

The second goal was to foster the cultural values of individual initiative embodied in the economic system of free enterprise. Fortunately, the values of private property and individual responsibility are basic to Islamic thought on human dignity. They are viewed as the key to the production of economic wealth which is a necessity if the ambitious Saudi plans for social justice are to be implemented. Thirdly, is the

promotion of the key institutions of Islam of which the highest ranking are the 'hajj' the Bedouins as the living example of Islamic values and, the practice of the 'Shari'a' which applies Islam to the legal system. Perhaps the Shari'a should be the major influence for all national planning - certainly, the more orthodox religious leaders say so. One of the most ambitious courses of action in bolstering the influence of the Shari'a was the decision in 1976 to found a new Islamic University in Mecca.

The fourth prime cultural goal of the guidelines is to control foreign culture in Saudi Arabia whilst harnessing foreign manpower, developing Saudi human resources, stimulating programmes of community development and expanding the role of the traditional legal system as a means to apply the Shari'a in modern life. In general, manpower planning in Saudi Arabia is designed to harness foreign manpower but replace it as rapidly as possible in order to minimise and control foreign manpower.<sup>12</sup>

In practice the Saudi Government has to deal carefully with religious leaders and opinion. Politically, an alliance between the ultra conservative religious group and the overseas educated intellectuals is seen as presenting the most probable possibility of radical change. The authorities are cautious not to allow a Saudi version of the Iranian Revolution to occur. So far, the pro-growth lobby has been successful in placating the conservative group. For example, in the spread of television, great care was taken to ensure that the Wahhabis and their followers were always consulted. The power of television to reinforce Islam has been used from the start.

Other examples of official sensitivity to religious opinion include the progressively harsher restrictions on employment, freedom of movement and educational opportunity for women, and also the strict adherence to laws concerning alcohol. Writers often point to the close tribal and family links of the Saudi royal family with the widely dispersed tribal groups in Saudi Arabia as the means by which the Saudi royal family feels the political pulse and controls Saudi society. Probably such factors are effective in maintaining the loyalty of most nationals. This system can act as a sensitive warning mechanism of any significant dissent although the take over of the Grand Mosque does not suggest this. Perhaps one of the most imminent threats to stability in Saudi Arabia comes from within the royal family itself. The very size of the family - numbering some 2,000 princes - engenders disagreements and marks fundamental differences based on traditional alliances.<sup>13</sup>

#### 1.5 FINANCIAL INFRASTRUCTURE

The financial institutions constitute a critically important element of any economy, especially one that is as dynamic as Saudi Arabia. Financial institutions affect the development of the economy and have been, in turn, fundamentally affected by that development. Presently, Saudi Arabia does not possess financial institutions equal in number or versatility to any western countries. The institutions that have developed are characterised by the way they are tightly controlled by government agencies. This control is exercised mainly by the Saudi Arabian Monetary Agency (SAMA) which acts as a central bank, although it does not

formally serve as a lender of the last resort. The currency is also managed by SAMA.

The Saudi Riyal (SR) is divided into 100 hallalas (H). For years its value remained pegged at the rate of SR 4.50 to the United States dollar, until the crisis of 1971 and the subsequent devaluation of the dollar. The final collapse in 1973 of the Bretton Woods financial agreements led to the establishment of a new parity, SR 3.53 per US dollar. However, the continual instability of the dollar meant that on 15 March 1975 the Saudis pegged the riyal to the Special Drawing Rights (SDR's), a unit of account consisting of a weighted average of 16 currencies. The official parity became 1 SDR = 4.28255 SR, with a trading band of plus or minus 7.5 per cent around parity. Still in practice, the Riyal was still expressed in terms of the US dollar, despite the continued fall of the dollar.

In 1977 the Riyal finally started to rise in relation to the dollar, reaching 3.25 to 1 US dollar in October 1978. It is not in the Saudi's interests to keep the dollar devalued with respect to the Riyal because 50 per cent of their foreign assets are denominated in dollars. Hence, as early as June 1979, the Riyal stood at 3.38 to the US dollar.

The role and influence of the Government is even more pronounced in its financial activities. It has been estimated that with the help of the oil revenues, the government sector was responsible for 86 per cent of gross national product in 1974. This percentage is likely to decrease in the future as the non oil sector of the economy undertakes its expansion programme. Consequently, the Government has created a vast network of

Table 1.5

GOVERNMENT AGENCIES WHICH PROVIDE FINANCIAL INCENTIVES

The Saudi Arabian Agricultural Bank  
 Established: By Royal decree in 1962  
 Head Office: Riyadh  
 Capital: SR 30 million. Liable to increase.

The General Investment Bank  
 Established: By Royal decree in 1971  
 Head Office: Riyadh  
 Capital: SR 1000 million. Increased to SR 3000 in 1974/75

Real Estate Development Fund  
 Established: By Royal decree  
 Capital: SR 250 million. Increased to SR 3000 million

The Saudi Industrial Development Fund  
 Established: By Royal decree in 1974  
 Head Office: Riyadh  
 Capital: SR 500 million. Increased to SR 3000 million

The Contractors Financing Programme  
 Established: By decision of Council of Ministers in 1974  
 Capital: SR 50 million. Liable to increase.

The Islamic Development Bank  
 Established: By decision of the Second Conference of the Ministers of  
 Finance of the Islamic State in 1974  
 Head Office: Jeddah  
 Capital: 2000 million Islamic dinars.

government agencies and institutions to provide loans and financial incentives which in more developed countries are normally provided by the private sector. A list of some of these institutions may be seen in table 1.5. In general, the table shows that the initial capital outlay for each institution has been increased in response to demand. Anyway, it should be noted that the institutions listed in table 1.5 follow Islamic principles. This means that loans are granted without interest although a small service charge is levied usually around 2 per cent per annum, to cover administrative overheads. Of course, the reason for this is that the Shari'a, or Islamic law, prohibits the taking of fixed returns or interest. This does give rise to difficulties.

For example, the absence of fixed interest payments means mortgages on houses are likely to remain in the hands of the real estate development fund. No private bank could afford to lend money without compensation especially with the Saudi inflation rate varying between 5 and 10 per cent. On the other hand, such interest free loans contribute a good deal to the economic growth of the country and the dissemination of wealth by allowing poor and middle class individuals to obtain funds under favourable conditions. There is, however, a need for the presence of private financial institutions.

These can be divided into three categories: banks from western origin, banks from Muslim countries and, Saudi Banks. The first banks to come from the west were the First National Bank of New York, the Algemeen Bank from Holland, the British Bank of the Middle East, followed by the Banque de l'Indochine et de Suez (France). Banks from other Muslim countries

include Banque du Caire (Egypt), Banque du Liban et d'Outremer (Lebanon), Bank Melli (Iran), the Arab Bank (Palestinian capital), the United Bank (Pakistan) and de Jazirah Bank (National Bank of Pakistan). Finally, the two Saudi Banks are the National Commercial Bank and the Riyadh bank. These Saudi banks have branches and offices across the country, while the foreign ownership banks were limited to between one and six. However, in 1977/78 the banks were forced to accept a 60 per cent Saudi ownership. All eventually complied. In each case, the Saudi controlling interest is obtained by increasing the capitalisation of the banks. At the same time, new shares are issued and bought by the Saudi public. The banks were also renamed to reflect their joint Saudi foreign character, for example, Banque de L'Indochine et de Suez became Bank Al Saudi Al Fransi and the British Bank of the Middle East became the Bank Al Saudi Al Brittani.<sup>14</sup>

The role of the commercial banks in providing development finance has been limited. Much of their lending has been to finance traders, mainly with their purchase of imports. Of course in so far as the imports purchased are capital goods, they may make a contribution to development. It is the question of import composition which will be considered in the next chapter.

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CHAPTER 2DETERMINANTS OF IMPORTS

Saudi Arabia commands a significant position in the international economy. The country is the third largest oil producer, endowed with approximately one quarter of the world's proven oil reserves. It is difficult to overstate the value of a working partnership with Saudi Arabia, founded on the principles of mutual economic co-operation and benefit. Despite the present depressed state of the petroleum market, Saudi Arabian purchasing power remains considerable. The policies the country follows have significant implications for the future of western exporters. The Second Development Plan needs an expenditure of \$149,500 million and Saudi Arabia plans to spend \$235,000 million in the Third Development Plan. As has been shown in chapter 1, Saudi Arabia is dependent on imports to a large extent for economic growth, and its massive expenditures have very important implications for western industrialised nations. In fact, they can be regarded as having a stake in the successful growth and development of the Saudi economy, as has Japan.

International trade is the 'backbone' of the Saudi economy. The oil sector accounts for 60% of the country's Gross National Product. The dependence of the economy on foreign trade can be determined by the ratio of total trade to Gross National Product. This reveals that the dependence of Saudi Arabia is nearly nine times greater than for a country like the

United States of America, a more 'closed' economy, although a different picture is obtained by comparisons with other smaller economies. Saudi economic expansion, induced by trade is based on interdependence and specialisation - the benefits from which may be reaped by all partners. In many ways, the greater the degree of trade, the greater are the benefits and progress towards economic development. As well as the standard static gains from trade through specialisation, there are transactions within the foreign sector which will provide certain 'dynamic benefits', such as the import of capital goods, technical and managerial skills and services and other infrastructure requirements which are essential to economic growth. In other words, international trade can be an 'engine of growth'<sup>1</sup>

This chapter looks at the determinants of imports. It has already been pointed out just how massive the expenditures involved are. Therefore, the policies followed by Saudi Arabia as regards its imports have far reaching implications. For example, the demand for swiss rolls from Saudi Arabia has signalled the prosperity of a firm in the north east of England. It is not only the kinds of food or goods imported which are significant. The expenditure involved is so large that the demand from Saudi Arabia can have significant multiplier effects, even in the developed industrial nations. These points and others are looked at below.

## 2.1 SECTORAL DIVISION OF IMPORTS

Firstly, it is instructive to look at table 2.1 compiled from the 1980 Yearbook of International Trade Statistics. This table examines imports by broad economic category as a percentage of the total value of imports

between 1974 and 1980. Category 1, food and beverages, shows a marked change between 1974 and 1980. The percentage of imports in this category has decreased from 17.1 per cent to 12.2 per cent and even this latter 1980 figure shows an increase on the lowest figure of 9.1 per cent in 1977. The situation regarding category 2 is quite a different one. Industrial suppliers have steadily increased their percentage of the total value of imports up to 1980. In contrast, category 3, fuels, as might be expected, commands a very small part of the total value of imports. There has been some variance between 1974 and 1980 but it represents only a very small percentage of the total value.

Category 4, a significant category by size, has more or less steadily increased. It was 16.3 per cent of the total in 1974 and rose to 27.1 per cent in 1978. However, 1979 and 1980 shows an apparently new declining trend when machinery represented 23.8 and 21.4 per cent respectively. The category of transport shows a decline in its percentage of the total value of imports. It decreased from 18.2 in 1974 to 15.2 in 1980 but the period in between has varied. The final category of table 2.1 is consumer goods which shows no very significant changes over the period. There has been a consistent move away from non-durable goods towards durable and semi durable goods.

Although looking at particular import categories as a percentage of the total value of imports can be useful, it can also be misleading. It does not show the changes of value of total imports. This means that the amount spent in a particular category can remain unchanged but if the total value of imports increased, it can represent a percentage decrease in total

Table 2.1

<u>Imports by Broad Economic Category (% of total value)</u>							
	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
1. <u>Food/Beverages</u>	17.1	13.7	10.4	9.1	9.9	11.0	12.2
Primary	6.8	6.2	4.2	3.9	4.1	5.2	6.2
Processed	10.3	7.5	6.2	5.2	5.8	5.8	6.0
2. <u>Industrial Supplies</u>	26.6	24.0	28.6	31.2	30.9	31.2	31.2
3. <u>Fuels</u>	0.9	0.6	0.7	0.5	0.7	0.6	0.6
4. <u>Machinery</u>	16.3	18.2	23.8	26.5	27.1	23.8	21.4
5. <u>Transport</u>	18.2	22.3	18.8	13.3	13.2	14.6	15.2
Industrial	8.1	10.8	11.0	6.8	5.4	6.2	6.1
6. <u>Consumer goods</u>	20.5	18.2	16.6	18.3	18.2	18.5	19.1
Durables	8.5	7.2	7.6	8.0	8.7	9.1	9.2
Semi durables	7.2	6.4	5.9	7.2	6.5	6.4	6.8
Non durables	4.8	4.5	3.1	3.1	2.9	2.9	3.0
TOTAL IMPORTS	100	100	100	100	100	100	100

Source: UN 1980 Yearbook of International Trade Statistics, Vol. I, p. 382.

value. This is particularly significant when observing a country like Saudi Arabia where the Saudi import position reflects the dynamic processes of development which the country is experiencing. The total value of imports rose approximately thirty times over the period 1960 to 1978 in current prices. During the period 1968 to 1978, total imports have grown from SR 2578 million to SR 69,180 million which represents a twenty-seven fold increase. The largest increases have occurred since 1973. From 1973 to 1978 there was an average 58 per cent annual growth rate. The sharp rise in the value of imports for these years may be attributed in part to inflationary price trends. Still a large proportion of the increase in the total value of imports must be attributed to the satisfaction of development requirements for the First and Second Development Plans. Part of this reflects an increase in the marginal propensity to import in the private sector, although many of the imports are a direct result of public spending programmes.

Recent figures released from the Saudi Central Department of Statistics suggest a deceleration in the growth of imports in 1979 to 16 per cent, compared with the high growth rate of 81 per cent in 1976. Thereafter, it accelerated to 20 per cent in 1980 and 22 per cent in 1981. Again, the primary factor responsible for this reversal is the growth in Government spending in 1979, 1980 and 1981 after its substantial deceleration in 1978. The role of the private sector is also more significant during this more recent period.<sup>1</sup>

A theme throughout this thesis is the Saudi Government's encouragement of the private sector. The Government urges the private sector to take the

initiative and in particular it shows a continual desire for wealthy individuals and entrepreneurs to have a stake in the successful development of the Saudi economy. It is interesting to note that the private sector has averaged over 76 per cent of the total value of imports since 1973, an encouraging sign. In 1977 and 1978 almost 22 per cent and 17 per cent respectively of the total import value went to the public non-oil sector. The oil sector accounted for 2.3 per cent and 5.4 per cent in the same two years. The share of the private sector climbed steadily during the Second Plan from approximately 68 per cent in 1975 to almost 78 per cent in 1978, again reflecting the Government's emphasis on the private sector as a force in the Kingdom's development.

If the actual composition of imported goods in absolute terms is observed, the combination of machinery, transportation equipment and electrical appliances is most significant. The total for this group increased from SR 846 million in 1968 to an estimated SR 28 880 million in 1978. There was also a very significant increase in the value of imports of glassware, precious/semi precious stones, precision instruments and sound equipment. Mallakh suggests that up until 1978 the third largest import category was building materials, refusing the Second Development Plan's emphasis on construction. Unfortunately, Mallakh tends to categorise imports in a rather different way to other specialists. However, despite the difference in combinations used, the same imports in general come out as significant, if in a slightly different order. Mallakh sees food imports as a substantial import category, ranking fourth in

importance with vegetable products, prepared items such as beverages and tobacco as well as dairy products, being significant.

It has already been pointed out above that there has been a downward trend in the relative share of foodstuffs to total imports, although in absolute terms there has been a steady increase in value. This, and the tendency towards increasing imports of manufactured goods, machinery and transport equipment, seems to indicate that imports will be primarily directed towards secondary activities. This is in response to the needs of the oil industry and the major infrastructural construction programmes for the development of utilities, highways, airports, communication networks and other facilities. Certainly, this latter tendency complies with the policy expressed in the Second Development Plan and the former corresponds with the idea of encouraging activities in what Saudi Arabia has a comparative advantage, which is inherent in the Third Development Plan.<sup>2</sup>

This shift in the composition of imports is exhibited very often in developing economies. As the increase in oil revenues leads to growing prosperity, the quantity of food demanded by the economy is increasing, but at decreasing rates. The relative shares of foodstuff imports to total imports has declined from 31.6 per cent in 1970 to 24.2 per cent in 1973 and to about 10 per cent in 1978. Mallakh examines private sector imports paid through commercial banks as a close proxy to actual trends in the composition of imports. These figures show that while the share of foodstuff imports has declined from 29.7 per cent in 1970 to an estimated 15 per cent in 1978, the share of capital goods has been rising at an

increasing rate. This reflects government policy. The Government is trying to shift resources from consumption to development.<sup>3</sup>

There is little discussion of Saudi economic policy regarding imports in the Third Development Plan. It states simply that the product composition of the Kingdom's imports for the two consecutive periods 1969/73 and 1973/77 "confirms the growing proportion of materials and machinery imports during the Second Plan period at the expense of food imports".<sup>4</sup> However, when discussing the strategy for the Third Development Plan, it states that the Kingdom will "continue its policy of diversifying the sources of purchases abroad to ensure better value and service"<sup>5</sup> - a point we turn our attention to in the next section. During the Second Plan period there has been a close almost one to one relationship between the current value of oil GDP and the value of imported goods and services, representing a high propensity to import. This is expected to continue in the Third Plan and allowance has been made for a slightly higher growth in imports than in non oil GDP on account of an expected rise in components and products substituting for labour.

## 2.2 SOURCES OF IMPORTS BY COUNTRY

Few would deny that the world is becoming increasingly interdependent. Yet, this has not generated an equitable sharing of the benefits of trade but the dichotomization of the world between the developed and the developing countries. The nations in the latter group generally supply primary products to feed the industries of the former with little or no influence on issues affecting even their own destinies. Developed

countries have a larger voice in world affairs, in part because they supply manufactured and sophisticated capital goods which have the characteristics conducive to attaining favourable terms of trade.

Also, developed countries have stronger bargaining power. Until the 1970's when the oil price increases catapulted oil-producing countries into the limelight of the international scene with Saudi Arabia in the centre, no supplier of raw materials from the developing world had received recognition consistent with the importance of that primary product.

Factors like the unilateral hike in oil prices and the fear of imminent exhaustion of the world's natural resources have meant a shift in the power relationship. This power has become almost permanent for the oil producing countries because of the nature of the raw material allowing organised action on the part of suppliers even when the market is weak. This is especially so for Saudi Arabia which has received world recognition within a relatively short span of time. As the country with the second largest exchange reserves and, as the principal exporter of petroleum globally, the Kingdom is an important power. Not only can Saudi Arabia support and so strengthen the developing block, the country as a massive importer, can choose which developed countries it wishes to support and strengthen. Although there are "hiccups" from time to time such as the January 1983 disunity of OPEC, Saudi Arabia is now important to the West as a major importer.<sup>6</sup>

There will be a close relationship between the change in the level of exports in any region and import changes, especially if value figures are

used which take account of the prices of traded commodities as well as quantities. Through the 1970's, petroleum exporters accounted for an increasing share of the regions import market, as might be expected. By 1975 Saudi Arabia in fact had overtaken Israel and become the second largest importer in the Middle East, as a consequence of its vast oil revenues. It has been regarded as paradoxical that a largely desert state with a small indigenous population still consisting of nomads for a large part, was able to import more than a country such as Turkey which has a population at least five times as large and a much more sophisticated economic structure.

The increased petroleum revenues have not only widened the gap between the oil exporting states such as Saudi Arabia and non-Arab Middle Eastern States such as Turkey as far as imports are concerned, but also caused a widening of the marked differential amongst the Arab states themselves. Expenditure on imports rose only slowly in Egypt, Syria, the Sudan and Jordan between 1968 and 1973. In real terms the increase was negligible as these countries suffered balance of payments difficulties. In 1974 however, all these countries were able to spend a much larger amount on imports owing to credits advance by their fellow Arab oil producing states. It was the benevolence of Saudi Arabia which allowed Jordan to continue purchasing petroleum at pre-1974 prices. This was halted by 1976 when it became clear that some of the oil supplied at concessionary prices was being resold to third parties! Anyway, by this time Saudi Arabia was spending more time appraising the domestic needs of the country. National self-interest became more important.

It has often been noted that the arbitrary distribution of oil wealth is unfortunate in the Arab world. For example, Egypt has a much greater need for imports than Saudi Arabia but the latter has a much greater capacity to import. Saudi Arabia and states like Libya lacked the required trained personnel and basic infrastructure to use the foreign exchange earnings for local development. In the past ships carrying import consignments often had to wait at Saudi Arabian ports for six weeks before they could unload. Even when the equipment was brought ashore in many cases there were long delays before it was installed. Also, large portions of funds have been spent indiscriminately on the imports of expensive durable goods such as luxury cars, while countries like Egypt have not been able to replace existing capital equipment in the manufacturing sector. Clearly, the imperfect market situation created by OPEC, led by Saudi Arabia means a growing import market in the oil producing states, but the trickle-down effect to the non oil producers of the Middle East has been minimal.<sup>7</sup>

At first sight there appears to be a tremendous scope for trade and commerce between the nations of the Middle East. To a large extent, these nations complement each other with regard to their resources. Yet, as will be seen below, Saudi Arabia only imports a small percentage of its total imports from Middle Eastern countries. For example, Saudi Arabia with its abundant financial resources but labour shortages, is an obvious location for capital intensive industries, especially those requiring a plentiful supply of cheap energy, although technological deficiencies would first have to be overcome. In contrast, Israel boasts a high level of technology and has a trained workforce yet suffers a shortage of revenue. Intraregional

specialisation would undoubtedly be advantageous as wasteful duplication of production facilities would be avoided. In the Middle East there are numerous instances of separate plants being developed simultaneously in several countries. As might be expected, each is operated at only a low level of its potential production capacity so that economies of scale are not taken advantage of. If each nation did specialise in the production of goods or services which it had a comparative advantage, intraregional trade would probably increase. While this does not occur, imports from Middle Eastern nations to Saudi Arabia will not reach their true potential.<sup>8</sup>

In contrast, the increase in European Community exports mirrored the oil import changes up to the mid 1970's, with export proceeds covering around half the import bill. After the 1973 oil price increase, the proportion of export receipts to import payments actually rose, from 47.4 percent in 1973 to 74.8 per cent by 1978, a remarkable export success for the European Community. Exports rose from 420 million European Community Units (ECU's)<sup>9</sup> to over 5659 million by 1978 and by 1980 to 7283 million ECU. The export problems associated with the demise of the Iranian market after the Revolution, illustrates the problems for the European Community of overdependence on a single Middle Eastern export market. Iran alone in 1978 accounted for almost 23 per cent of all European Community sales to the Middle East, while Saudi Arabia accounted for almost 22 per cent of export sales. By 1980 the Saudi Arabian share had risen to over 23 per cent, while the share of Iran had fallen to 10 per cent. Given Saudi Arabia's ambitious development plans and apparent stability, prospects for Community exports continue to be encouraging. Prospects for countries such

as Libya look less certain, particularly after the April 1984 shooting of a British policewoman, outside the Libyan Embassy.

European exports to the Middle East do not have the problem of over dependence on a single commodity, unlike Middle Eastern exports to the Community. Most European Community exports comprise manufactured goods, machinery, capital equipment and supplies for the construction industry, and the prices of these items are much less volatile than those of primary commodities such as oil, despite OPEC. The deterioration in the European Community's terms of trade in 1973-74 and again in 1979 is well known, but still the long-run underlying trend has been for manufactured goods to appreciate in price vis-à-vis primary commodities, including oil. Predicting the future price trends in oil vis-à-vis the price of manufactured goods is not a simple task. Oil prices not only affect the value of European Community imports from the Middle East, but also affect European community exports by ultimately, determining the ability of the Middle Eastern states to pay for Community exports. If oil prices fall, however, the effect on European Community exports is likely to be less marked than the impact on import savings. The time lags may be greater before any effects work their way through to Community exports, whereas the effect on the Community's bill is more immediate.

The ambitious development plans for industrialisation and social infrastructure represent long-term commitments on the part of the oil-exporting countries and they cannot easily be scaled down in response to short-run petroleum price falls. Saudi Arabia along with the other less populous Gulf states, has substantial official reserves to carry itself

## Sources of Imports 1968-78 (SR millions)

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
U.S.A.	571	622	569	615	917	1,407	1,735	2,538	5,739	9,621	14,434
Europe	807	1,281	1,150	1,295	1,438	2,079	2,696	4,669	10,844	19,424	31,323
Common Market (EEC)	721	1,120	979	1,116	1,228	1,721	2,542	3,784	8,327	15,624	24,742
of which: Belgium	57	82	65	91	88	172	308	243	512	832	1,234
France	65	123	88	79	108	156	180	332	821	1,728	2,668
Germany	174	267	313	289	294	458	612	1,017	2,538	4,320	7,467
Italy	115	117	143	161	191	198	280	578	1,504	3,168	4,945
Netherlands	119	170	140	169	193	256	403	430	1,135	2,278	3,011
U.K.	192	301	231	328	345	466	492	1,147	1,815	3,182	5,093
Other Western Europe,	48	108	102	102	117	198	266	768	1,189	3,430	5,607
of which: Switzerland	15	50	44	52	49	100	118	419	1,094	1,510	1,952
Eastern Europe	37	52	69	77	93	161	139	117	328	370	974
Middle East	554	629	636	810	1,009	1,625	2,836	3,647	7,296	7,243	2,739
of which: Bahrain	30	44	47	79	92	152	238	201	640	762	156
Jordan	44	64	46	41	50	49	100	135	620	429	264
Kuwait	42	46	63	86	136	252	445	722	2,690	2,300	359
Lebanon	267	334	363	474	579	867	1,547	1,537	739	1,165	1,064
Syria	49	53	51	55	97	207	330	681	2,019	1,816	326
Asia	463	625	611	712	1,025	1,641	2,487	3,152	5,673	10,468	17,612
of which: India	47	93	102	69	84	93	194	153	329	601	805
Japan	234	348	314	414	676	1,133	1,616	2,267	3,371	5,981	10,659
Pakistan	55	44	31	48	50	68	120	153	236	238	322
Africa	145	152	127	152	216	225	272	321	366	451	710
of which: Somalia	106	97	87	105	141	115	110	173	166	122	304
Oceania	31	62	95	66	86	183	89	104	128	310	537
Others	8	5	10	17	17	36	34	392	536	3,868	1,341
TOTAL	2,578	3,377	3,197	3,668	4,708	7,197	10,149	14,823	30,691	51,662	69,180

Source: El Mallakh, R. Saudi Arabia: Rush to Development, p. 352

over any short term adverse balance of trade movements. It also receives income from its overseas investments and nowadays, this has become an important invisible current account item. A further factor which results in some degree of stability in European Community export sales to the Middle East is that many deals are worked out on a medium or long-term contract basis, especially for intermediate and capital goods. Saudi Arabia like most Middle Eastern customers is careful not to obtain a bad reputation for its treatment of suppliers. If it does, tenders in the future would build in a higher premium for risks, adding to import costs.<sup>10</sup>

The major sources of Saudi Arabian imports in 1978 were Western Europe, the United States of America and Japan, as table 2.2 shows. The rapid growth of Saudi imports that we have already examined has not been accompanied by any distinct changes in the position of suppliers of these imports. Nevertheless, Western Europe has dramatically increased its share from 36 per cent in 1970 to 45 per cent in 1978. Most notable of these European nations have been West Germany, the U.K. and Italy which have ranked in that order since 1975. The U.S.A. supplied an average of just over 19 per cent of the Saudi imports between 1970 and 1978; the American share was raised to almost 21 per cent in the latter year. Behind the U.S.A. the second largest, single nation-supplier in the 1970's was Japan. Its share expanded from 9.8 per cent to 15.4 per cent of the Saudi import market in 1978.<sup>11</sup> The latest figures from the Central Department of Statistics indicate that in 1980 the U.S.A. and Japan remain the first and second leading exporters with 20.4 and 17.3 per cent of the share of imports. However, as table 2.3 shows, the UK has now increased its share of imports from 6.9 per cent in 1979 to 8.7 per cent in 1980 whereas

Table 2.3

Saudi Imports by Origin

	(Million Dollars)						
	1978	1979	1980	Percent change in 1980	Percent share in 1980	First half	
						1980	1981 <sup>P</sup>
U.S	4,370	4,875	5,768	18.3	20.4	2,727	3,457
Japan	3,284	3,803	4,882	28.4	17.3	2,213	2,773
Germany	2,079	2,412	2,358	-2.2	8.4	1,173	1,110
U.K.	1,511	1,895	2,441	28.8	8.6	1,156	1,228
Italy	1,467	1,883	2,075	10.2	7.3	1,006	946
France	877	1,100	1,456	32.4	5.2	684	718
Six-country sub-total	13,588	15,968	18,980	18.9	67.2	8,959	10,232
Other 8 industrial countries	2,412	2,838	4,123	45.3	14.6	1,485	1,514
Total 14 industrial countries	16,000	18,806	23,103	22.8	81.8	10,444	11,746
Rest of the World	4,021	4,725	5,135	8.7	18.2	2,611	
Total FOB imports (in dollars)	20,021	23,531	28,237	20.0	100.0	13,055	
Estimated freight and insurance	3,404	4,000	5,083	27.1		2,220	
Total imports, CIF (in dollars)	23,425	27,531	33,320	21.0		15,527	
(in Riyals)	79,636	92,526	110,846	19.8		50,976	
Weighted average exchange rate (Rls per \$)	3.3996	3.3608	3.3267			3.3372	3.3523

Sources: Central Department of Statistics, Partner-country, Data and Capital SAMA estimates.

Source: Kingdom of Saudi Arabia The Statistical Indicator. 7th edition, 1982, p. 48

Germany has decreased its share from 8.7 to 6.7 per cent, respectively. The UK thus becomes the third largest producer of exports to Saudi Arabia with Germany fourth.<sup>12</sup> Regional Middle Eastern trade accounted for slightly over 14 per cent of Saudi imports between 1970 and 1978 with Lebanon being the most regular supplier from year to year.

Although the balance of trade will be more fully examined in chapter 6, it is interesting to note here that in 1978 West Germany and the UK were the only nations with which Saudi Arabia had a net deficit in their current accounts. Since 1974, when the terms of trade were most favourable to the Kingdom as a result of the massive 1973/4 oil price hikes, various forces have been in operation relative to the balance of trade. While the tendency has been for surpluses to deteriorate with increased Saudi demand for imports in the public sector because of economic development needs, and in the private sector due to rising standards of living, the demand for oil from certain nations (such as Japan, France and the USA) has kept the balance largely in favour of Saudi Arabia.

### 2.3 TARIFF AND IMPORT CONTROLS

The range of protective duties in Saudi Arabia is very limited in comparison with other Middle Eastern nations. In comparison with countries such as pre-revolutionary Iran, Saudi Arabian duties are much less restrictive, as might be expected given that the country is an even larger oil producer than Iran but has a population only a fraction of the size. Saudi Arabia grants tariff protection to 29 local infant industries, most of which manufacture consumer non-durable. These include items such as

detergents, paper handkerchiefs and chocolate, where imported goods are subject to 20 per cent duty. Cars and commercial vehicles enter with only a 3 per cent tariff, and there are no duties payable on imported machinery or capital equipment. In 1975, however, a joint venture company was set up, Saudi Arabia Motors, in which General Motors of Detroit held 60 per cent of the capital, with 40 per cent subscribed in Saudi Arabia. This new company has been licensed to assemble 7800 vehicles a year, including Chevrolet Trucks, a small number of buses and, Torana cars, a successful Australian model. It is expected that tariff protection will be given to the new company's vehicles. As a consequence, General Motors hopes the value of its exports to Saudi Arabia will actually rise after the opening of its subsidiary, as it expects that it will increase its market share, which would mean greater sales of American vehicle components.

Although in Saudi Arabia the number of commodities subject to import duty is limited at present, as the country develops new infant industries the range of tariffs is likely to be extended. This will largely affect consumer durables in the first instance which will enjoy a high degree of effective protection, as intermediate and capital goods continue to enter free of duty for the foreseeable future. Such a tariff policy should do much to encourage expansion of infant industries in fields where there is a reasonable market. The scope for domestic capital or intermediate goods manufacture in Saudi Arabia seems much less promising, despite the country's ambitious plans for the steel industry. Any tariff protection on steel may only serve to lower the effective protection given to consumer goods industries, and lower their prospects of profitability.

Perhaps Saudi Arabia represents the beginning of a trend away from free trade in the Middle East. Still there are some countervailing forces at work, such as the Arab Common Market although Saudi Arabia did not join this as they feared trade diversion effects would outweigh possible trade creation. Another factor actually encouraging trade has been the subsidies introduced on food imports by Saudi Arabia as well as other Gulf states which in effect constitute a negative tariff. They were brought in basically as an anti-inflation measure to augment available food supplies and keep down internal prices. In practice, they reduce wage pressure by lowering the rate of cost of living increase which effectively increases the rate of effective protection for domestic industry. However, such measures do not encourage local agriculture.

Many of the countries of the Middle East have adopted some system of import licensing whereby prospective importers have to apply to the government for permission to purchase foreign goods. However, Saudi Arabia has no such policy. There are no quantitative restrictions on imports apart from goods from Israel where the pro-Palestinian, Arab boycott applies, and imports from Zimbabwe (formerly Rhodesia) which were prohibited under the United Nations sanctions policy until 1982. Neither are imports of alcoholic beverages allowed, as consumption of alcohol is forbidden under Islamic Law.<sup>13</sup>

Exchange arrangements in Saudi Arabia are quite straightforward. As discussed at the end of Chapter 1, the currency of Saudi Arabia is pegged to SDR and December 31, 1981 ISDR=SRls 4.28255. Saudi Arabia at present applies margins not exceeding 7.25 per cent around that fixed relationship.

The middle rate of the Saudi Arabian riyal for the US dollar, quoted by the Saudi Arabia Monetary Agency (SAMA) is determined on the basis of the funds's daily calculation of the US dollar -SDR rate. On December 31 1981 SAMA's middle rate for the US dollar was SRls 3.415. It sold US dollars to banks at SRls 3.42 per US \$1 and bought from banks and the principal producer of petroleum at SRls 3.41 per US \$1. These rates served as the basis for exchange quotations in the market, the banks being permitted to charge up to 0.25 per cent above and below the monetary Agency's buying and selling rates. The Monetary Agency also sells sterling to banks. There are no taxes or subsidies on purchases or sales of foreign exchange. However, the use of currencies of Israel and South Africa is prohibited, although no other of currency requirements are in force. Payments may not be made to Israel or South Africa or be received from them for all types of transactions whether of a current or capital nature.

No exchange control requirements are imposed on capital receipts or payments by residents or non residents. SAMA has issued guidelines to its foreign correspondent banks requiring them to seek approval prior to the flotation of riyal-denominated loans. The Foreign Capital Investment Law provides for specified benefits to be extended to approved foreign investments in Saudi Arabia. Approved foreign capital enjoys the same privileges as domestic capital under the 1962 Law for the Protection and Promotion of National Industry. Further, capital invested in industrial or agricultural projects with at least 25 per cent Saudi Arabian participation is exempt from income and corporate tax for ten years after production has begun. The situation regarding gold is also simple. The monetary authorities and all other residents, including private persons, may freely

and without license, purchase, hold and sell gold at home or abroad. They may also, without a license or payment of any customs duty or tax, import and export gold in any form. This is with the exception of 14-carat gold—the import of which is prohibited.<sup>14</sup>

The liberal payments system gives little protection to local industries and the link with the SDR promotes trade rather than import substitution. As the exchange rate is very stable vis à vis the currencies of most of the country's trading partners, this has encouraged imports. Furthermore, as the SDR has appreciated modestly against most European currencies and the Japanese yen, this has made it more attractive for Saudi importers to purchase from these countries in recent years. The extent to which the modest exchange rate changes have promoted total imports, or merely resulted in the substitution of one source of foreign supply for another must, however, remain a matter for debate.

#### 2.4 ABSORPTIVE CAPACITY OF SAUDI ARABIA

Since 1974 Saudi Arabia has had the second largest international reserves in the world. In 1977 Saudi reserves were valued at US \$30 billion compared with \$39.7 billion for West Germany and \$19.4 billion for the USA. By 1981, these reserves almost reached \$40 billion.<sup>15</sup> As a result of the Kingdom's oil revenues and the country's inability (or refusal) to absorb this wealth through domestic consumption and investment, Saudi Arabia now has a significant status in international liquidity. These surplus funds and the Saudi requirement for economic development obviously have important implication for the future demand for imports.

Various projections of Saudi Arabia's ability to absorb real goods and services have been made, based upon the growth of the Kingdom's economy. This concept of absorptive capacity has been defined as "that amount of investment ... as a proportion of GNP, that can be made at an acceptable rate of return. The future of Saudi Arabian economic development must be focused upon its ability to expand its absorptive capacity and subsequently, the ability to import goods and services."<sup>16</sup> The above mentioned overall increase in imports shows that constraints and growth were overcome in previous years, and a considerable expansion in absorptive capacity has taken place.

According to a US Department of Treasury study, the major constraint upon the achievement of the Second Plan's objective of increasing imports by 30 per cent per year consisted of manpower shortages and the inefficiency of air and sea ports. While facilities for importing to the Kingdom were inadequate during the early 1970's substantial expansion in the Second Plan period increased port capacity to 130 berths in 1980 from the 24 in operation in 1975. For example, the Gulf port of Dammam raised its port capacity more than fourfold to 12.7 million deadweight tons in 1980.

The Treasury Department study predicted a moderate rate of import growth to 1980, thereafter accelerating sharply once the major constraints were overcome, to an estimated SR 61 422 million (17.4 billion in constant 1974 dollars) by 1985. However, this study underestimated the ability of the Saudi economy to absorb imports. The total imports in 1978 had already exceeded the 1985 projection. Apparently, a 1976 study prepared

for the US Department of State, where Saudi import projections were based upon the absorptive capacity of the country and a 'particular oil revenue scenario', was not correct either. Physical constraints to the expansion of domestic absorptive capacity included population, manpower and infrastructure and, the implementation of the Second Development Plan was seen as questionable. A subsequent study suggested that such constraints "... are not expected to prevent Saudi Arabia from experiencing a high rate of economic growth or continuing to increase imports rapidly."<sup>17</sup> The result of this latter study predicted a 14.4 per cent average annual growth rate of imports until 1980, thereafter slowing down to 4.7 per cent per year up to and until 1985. Relative shares of imports of major trading partners were expected to remain generally the same as in the past.

As stated above, imports increased at a 64 per cent average annual rate between 1975 and 1978. Also, the source of imports shifted slightly in the direction of Western Europe, Japan and the USA. Further, the projections of planners for the 1980-85 span are for imports to grow at a 7 per cent annual figure. The absorptive capacity of the Saudi economy has therefore expanded faster than many predictions suggested it might.

With the restricted growth projections for the Third Development Plan, import growth is projected to return to its historical trend of approximately 7 per cent average annual increase. However, as import markets continue to develop in the Saudi economy, the reciprocal relationship between growth and trade will become increasingly wide. Furthermore, to the extent that surplus oil revenues exceed absorption capacity, reflecting the level of that country's imports, Saudi Arabia's

holding of international reserves and foreign exchange will continue to grow.

## 2.5 IMPORT DETERMINANTS

Table 2.4 shows that the value of imports increased every year between 1965 and 1980 in Saudi Arabia. Between these years the value of imports increased about seventy times. The increases in the value of imports were much larger after 1973. For example, between 1968 and 1972 there was a forty per cent increase, while between 1973 and 1974 alone imports doubled, as they did between 1974 and 1975. This would suggest that the increase in demand for imports up to 1973, reflected the pace of economic development in Saudi Arabia. However, the increase in oil prices and revenues received by Saudi Arabia, meant the removal of financial constraints in the short term after 1973, as discussed in Chapter 1. This massive increase in the purchasing power of Saudi Arabia was immediately reflected in the demand for imports, as Saudi industries were insufficiently developed.

Consequently, between 1975 and 1978 there was an approximate 50 per cent increase per annum in the total value of imports. Even when inflation is accounted for, this real rise was still substantial and probably 40 per cent per annum. The Government's recognition of the problem of inflation meant a policy to curb inflation which is reflected in the 1978/79 figure.

Between 1978/79 there was a comparatively small increase in the total value of imports of approximately 15 per cent suggesting that the authorities had managed to control inflation. This was followed by an approximate 30 per cent increase between 1979/80. Some of the determinants

Table 2.4

Import Determinants

Year	Imports	Govt. Consumption	Govt. fixed Capital Formation	Private Consumption	Consumer Prices (1975 = 100)
t	M	G	I	C	P
1965	1,948	1,654	1,712	2,909	43.9
1966	2,255	1,915	2,330	3,026	44.6
1967	3,538	2,674	2,158	4,001	45.5
1968	4,392	2,747	2,392	4,585	46.3
1969	4,851	3,026	2,632	5,360	47.9
1970	4,990	3,421	2,597	5,859	48.2
1971	5,205	3,798	2,933	6,412	50.3
1972	6,303	4,285	3,403	6,914	52.5
1973	8,272	5,335	5,694	7,896	61.2
1974	15,293	9,864	8,400	9,828	74.3
1975	17,257	15,911	17,699	18,039	100.0
1976	42,863	28,883	33,540	23,903	131.6
1977	62,699	41,033	51,191	34,372	146.5
1978	91,505	47,034	66,891	54,607	144.2
1979	107,479	71,904	76,654	60,845	146.8
1980	134,351	88,206	94,977	70,186	151.5

million riyals

Source: IMF, International Financial Statistics, 1981 Yearbook, p. 367.

SAMA Annual Report 1399 (1979), p. 161

of imports show similar changes during the 1970's. Government consumption increased more than 50 per cent each year from 1973 to 1977. The Government's policy to reduce inflation is shown clearly in the decreasing rate of the increase in government consumption. Between 1977 and 1978 the increase in government consumption was less than 20 per cent. The Government was also successful in reducing fixed capital formation. There were very large increases in this item up to 1977 when the rate of increase began to slow down. Between 1978/9 the Government had managed to reduce the increase to approximately 15 per cent. Likewise, private consumption shows quite a steady increase up to 1978. However, private consumption only increased by approximately 10 per cent between 1978/79 and 15 per cent between 1979/80 suggesting perhaps a less significant relationship between private consumption and total imports than government consumption and imports. It appears to be easier for the Government to control government consumption than private consumption.

To verify whether government consumption, government fixed capital formation and private consumption were significant factors in explaining the changing trends for the total value of imports, formal linear regression analysis was applied, with the relationship postulated of the form

$$m = a + bG + cI + dC \quad (1.0)$$

where the dependent variable M is total value of imports, the independent variables G, I and C being government consumption, government fixed capital formation and private consumption, respectively. The parameters a, b, c, and d are to be estimated when applied to annual data from 1965 to 1980 (16 observations), this yielded the result

$$M = -4242.95 + 1.50 G - 0.84I + 1.33C \quad (1.1)$$

$$(-2.26) \quad (24.50) \quad (-2.44) \quad (2.91)$$

Figures in parentheses are t values,  $R^2 = 0.99$ , Durban Watson = 1.13. The equation reveals a significantly positive relationship between government consumption and imports and to a lesser extent private consumption, as might be expected. There is however, an apparently negative relationship between government fixed capital formation (I) which is quite significant given its t value. This might be explained in that I does not vary so much in the short term as it is dependent on medium- and long-term contract agreements.

The Durban Watson value in equation 1.1 is low, revealing autocorrelation. The Cochrane-Orcutt iterative least squares technique was used in equation 1.2 in an attempt to boost the Durban Watson value. This failed.

$$M = -3.52707 + 1.44G - 1.17I + 1.74C \quad (1.2)$$

$$(0.98) \quad (19.34) \quad (-4.72) \quad (5.46)$$

$$(R^2 = 0.98, \text{ Durban Watson } 0.85)$$

A better result was obtained when imports were regressed against the same independent variables (G,I and C), but using t-1 where subscript t represents time. This was done because it is likely that the dependent variable might be influenced by the independent values of the year before. The equation for the regression is thus written

$$M = a + bG_{t-1} + cI_{t-1} + dC_{t-1} \quad (2.0)$$

Equation 2.1 reveals a positive relationship between government consumption and imports and private consumption to a lesser extent. The t value for

government fixed capital formation suggests the revealed negative relationship is not significant. Furthermore, the Durban Watson value reveals autocorrelation.

$$M = -1113.33 + 1.85G - 0.01I + 0.46C \quad (2.1)$$

$$(-0.65) \quad (33.63) \quad (-0.03) \quad (1.13)$$

$$(R^2 = 0.996, \text{ Durban Watson Value } 0.90)$$

After correction using the Cochrane Orcutt iterative technique this becomes

$$M = -376.37 + 1.84G - 0.015I + 0.41C \quad (2.2)$$

$$(-1.16) \quad (30.64) \quad (-0.07) \quad (1.42)$$

$$(R^2 = 0.996, \text{ Durban Watson value } 1.88)$$

In equation 2.2 the Durban Watson value is satisfactory. The significantly positive relationship remains particularly with government consumption and imports and also with private consumption. The low negative t value of government fixed capital formation(I) suggests that the relationship is a weak one however, it is notable that I is negative throughout equations 1 and 2. Equation 2 suggests that the determinants of imports may well be affected by earlier values.

Therefore, in equation 3 each independent variable G,I and C was observed minus its value in the preceding year that is, the import level was regressed against changes in the independent variables. The equation for the regression is thus written:

$$M = a + b (G-G_{t-1}) + c(I - I_{t-1}) + d(C - C_{t-1}) \quad (3.0)$$

The Durban Watson Value was too low again revealing autocorrelation in 3.1 as follows

$$M = -2461.72 + 6.17 (G-G_{t-1}) - 3.87 (I-I_{t-1}) + 5.73(C-C_{t-1}) \quad (3.1)$$

$$(-0.86) \quad (18.27) \quad (-6.18) \quad (7.03)$$

$$(R^2 = 0.97, \text{ D.W.} = 1.03)$$

After correction using the Cochrane-Orcutt technique this becomes

$$M = -846.88 + 6.0(G-G_{t-1}) - 3.46(I-I_{t-1}) + 5.20(C-C_{t-1}) \quad (3.2)$$

$$\begin{array}{cccc} (-0.17) & (12.21) & (-6.49) & (7.42) \end{array}$$

$$(R^2 = 0.94, D.W. = 1.56)$$

In equation 3.2 a satisfactory Durban Watson value was achieved. This equation reveals a different emphasis in the importance of government consumption, private consumption and imports. Private consumption is comparatively more significant than in equation 1 and 2, although government consumption according to the t values is most significant. Also, the t value for government fixed capital formation is strongly negative perhaps reflecting medium- and long-term contractual agreements, as suggested above.

In equation 4, when regressing changes in imports against changes in G, I and C, the results were less promising. Formal linear regression analysis was applied and the equation thus written

$$M_t - M_{t-1} = a + b(G_t - G_{t-1}) + c(I - I_{t-1}) + d(C - C_{t-1}) \quad (4.0)$$

The annual data from 1965 to 1980 gave the result

$$M_t - M_{t-1} = 559.66 + 1.34(G - G_{t-1}) - 1.12(I - I_{t-1}) + 1.67(C - C_{t-1}) \quad (4.1)$$

$$\begin{array}{cccc} (0.48) & (9.87) & (-4.43) & (5.08) \end{array}$$

$$(R^2 = 0.92, D.W. \text{ Value} = 0.80)$$

Once again a low Durban Watson Value was obtain revealing autocorrelation. After correction using the Cochrane Orcutt iterative technique, the Durban Watson value was not boosted sufficiently as equation 4.2 shows.

$$M_t - M_{t-1} = 2578.88 + 0.91(G - G_{t-1}) - 0.87(I - I_{t-1}) + 1.32(C - C_{t-1}) \quad (4.2)$$

$$\begin{array}{cccc} (0.70) & (3.65) & (-4.42) & (4.91) \end{array}$$

$$(R^2 = 0.84, D.W. = 1.17)$$

When imports are regressed against G, I and C using logarithms the results achieved are better. The equation for the regression is thus written

$$\text{Log M} = a + b \log G + c \log I + d \log C \quad (5.0)$$

Once more annual data from 1965 to 1980 was used giving the result

$$\text{Log M} = -0.93 + 1.06 \log G - 0.20 \log I + 0.28 \log C \quad (5.1)$$

(-2.18) (21.73)          (-1.64)          (2.13)

$$(R^2 = 0.99, \text{ D.W. value } 1.39)$$

Quite a reasonable Durban Watson Value was obtained. Using logarithms tended to confirm the results of earlier equations. Government consumption seems to be the most significant determinants of import and private consumption is also positively related. Notably, government fixed capital formation was negative again.

Given this quite promising result, equation 3 was repeated using logarithms. The equation for the regression is thus written

$$\text{Log M} = a + b \log G_{t-1} + c \log I_{t-1} + d \log C_{t-1} \quad (6.0)$$

The annual data between 1965 to 1980 gave the result

$$\text{Log M} = -0.03 + 0.95 \log G_{t-1} + 0.23 \log I_{t-1} - 0.10 \log C_{t-1} \quad (6.1)$$

(-0.03) (8.72)          (0.92)          (-0.35)

$$(R^2 = 0.98, \text{ D.W. Value} = 0.76)$$

The results in 6.1 cannot be used as the Durban Watson Value is too low.

When using the data between 1965 and 1980, in general equations 1 to 6 tend to confirm that government consumption is a significant determinant of imports. This is also true of private consumption but to a much lesser

degree. Therefore, it could be said that if the Saudi Government wishes to influence imports, government economic policies could well be used successfully. It is interesting to note that government fixed capital formation has consistently obtained a negative result as a determinant of imports, a robust result that a cursory glance of the data would not suggest.

As was suggested in the first part of this section, 2.5, the price level affected the value of imports to some extent. As all the data are in current prices, the close relationship may only reflect variations in the role of price increase. In order to find out how significant this factor has been, equations 1 to 6 are used once more including Consumer Prices (1975 = 100). Three of the results were useful and are stated below. That is, formal linear regression analysis was applied with the relationship postulated of the form

$$M = a + bG + cI + dC + eP \quad (7.0)$$

where the dependent variable M is total value of imports and the added independent variable P, is Consumer Prices. In the following equations, a, b, c, d and e are to be estimated. When applied to annual data from 1965 to 1980, this yielded the result

$$M = 9918.93 + 1.34G - 1.01I + 1.50C + 97.89P \quad (7.1)$$

$$(-3.03) \quad (18.21) \quad (-3.17) \quad (3.62) \quad (2.02)$$

Figures in parentheses are t values,  $R^2 = 1.0$ , Durban Watson = 0.95. This equation reveals a positive relationship between Consumer Prices and the value of imports. The relationship is weaker than that with private consumption or government consumption. The equation confirms the negative relationship of fixed capital formation (I) with imports, as seen in earlier equations.

As with equation 2, when consumer prices were discluded, a better result was obtained when imports were regressed against the same independent variables (G, I, C and P) but using t-1. The subscript t denotes time. It assesses whether the dependent variable was influenced by the year before. The equation for the regression is thus written

$$M = a + bG_{t-1} + cI_{t-1} + dC_{t-1} + eP_{t-1} \quad (8.0)$$

Equation 8.1 reveals a more positive relationship between Consumer Prices and imports, although government consumption and imports have the strongest relationship. Private consumption only achieves a t value of 2.52 and I is less significant with a t value of -1.66. A satisfactory Durban Watson value was also achieved.

$$M = 12369.69 + 1.56 - 0.40 + 0.75 + 225.26 \quad (8.1)$$

$$(-3.56) \quad (16.66) \quad (-1.66) \quad (2.52) \quad (3.43)$$

(R<sup>2</sup> = 1.0, Durban Watson = 1.72)

When imports are regressed against G, I, C and P using logarithms a useful result is obtained. The equation for the regression is thus written

$$\text{Log } M = a + b\text{log}G + c\text{log}I + d\text{log}C + e\text{log}P \quad (9.0)$$

Once again, annual data from 1965 to 1980 was used giving the following result

$$\text{Log } M = -1.93 + 0.91 - 0.39 + 0.45 + 0.58 \quad (9.1)$$

$$(-1.95) \quad (6.41) \quad (-1.88) \quad (2.26) \quad (1.1)$$

(R<sup>2</sup> = 1.0, D W value = 1.42)

The use of logarithms confirmed the results of the above equations for the most part. Equation 9 shows a positive relationship between Consumer Prices and imports, although one that is less significant than G or C. It also reveals a negative relationship between capital fixed investment and

imports. A reasonable Durbin Watson value was obtained in this equation.

## 2.6 CONCLUSION

Equation 1 to 9 attempt to assess the significance of some of the major determinants of imports. The first six equations look at government consumption (G), capital fixed formation (I), and private consumption (C). In each case, the revelation was that G was the major determinant and C was significant but to a lesser extent. Additionally, I remained negative throughout so that it must be concluded that it did not influence the level of imports. Equations 7 to 9 included the independent variable, Consumer Prices and they attempt to assess the role of inflation in the determining of imports between 1965 and 1980. Each equation revealed a positive relationship for this variable but P's t value was always much lower than G. This shows that even when Consumer prices are included in the equation, G is still the major determinant and I still negative. Price variations for imports and domestic macro variables does not explain the relationships found.

As investment does not appear to be a major determinant of imports, this implies that capital formation in import substitution industries will have little negative impact on the balance of payments. This agrees with data presented earlier in this chapter. Indeed the creation of such industries may eventually weaken the link between government expenditure, private expenditure and imports. Although Saudi Arabian government policy is not constrained in the medium term by balance of payments considerations, it may be in the future if the demand for oil weakens

further. Diversification into import substitution industries will ultimately give the government more independence in its policy decisions, while at the same time the short term import costs seem likely to be minimal given the evidence presented here.

In western countries it is often stated with various motives that increases in government consumption can only take place at the cost of lowering investment. The suggestion is that the size of the 'cake' cannot be made larger so that one squeezes the other out. This does not appear to be the case in Saudi Arabia. Perhaps the removal of financial constraints in the 1970's has given rise to a different situation.

It has been noted above that the growing demand for imports could be seen as a reflection of the pace of development. Some economists have been surprised by the ability of the Saudi Government to increase the pace of development, as revenues increased. The absorptive capacity of the economy has been underestimated in the past. Financial reserves have also been observed briefly in chapter 2. Oil revenues have been fluctuating in the 1980's because of the over capacity in the oil market and it is likely that financial reserves will reflect decreases and increases in oil revenues. However, in the above analysis, government consumption has clearly been shown to be the major determinant of imports so that the Saudi Government must be well placed to influence demand for imports. This must mean that the potential for the government to influence the pace of import substitution policies is also great. A factor which which could be used to the benefit of the country.

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## CHAPTER 3

### SCOPE FOR IMPORT SUBSTITUTES

#### 3.1 IMPORT SUBSTITUTION POLICIES

Saudi Arabia is aware of the difficulties associated with relying on export trade as the main 'engine of growth'. Over-dependence on the export of one commodity makes the economy extremely vulnerable to changes in world market conditions. Adverse price trends and uncertainty with regard to fluctuations in market prices provides an economic rationale for the adoption of an import substitution policy as an alternative to specialisation in export production. This was not possible in the early 1960's because it was unclear that such a quantity of foreign exchange would be available to finance imports. Politically, import substitution policies are an economic manifestation of the desire for national independence, as well as being part of the nation-building process.

When the period of easy growth that is, oil dependent growth comes to an end, the economy will have to "normalise". Normalisation means that the Kingdom will become more dependent on the mobilisation of domestic resources. The public sector will have to increase the share of domestic (non oil) revenues in total revenues and the private sector will have had to reach a level of sophistication where it is capable of depending on private savings and corporate profits for its growth momentum. Like other countries of the Middle East, Saudi Arabia wants to industrialise as the only viable means of development. Of the productive sectors, agriculture,

industry, mines and services, only the industry and mining sector offers even the slightest possibility of achieving import substitution. The possibility for growth in agriculture and livestock, the most traditional sectors, is limited because of lack of water, arable land and the unwillingness of Saudi labour to pursue a career in farming.<sup>1</sup>

In short, an industrial revolution is seen as a necessity. The need to diversify the industrial base is accepted. This is despite the probable emergence of an urban proletariat which might provide the basis for leftist parties and oppose the conservative Saudi Government. In Saudi Arabia there has been little indigenous industry until recently so most industrialisation constitutes import substitution. It would, however, be unfair to suggest that the country is totally without industrial tradition. Production of 10-13 million barrels per day of oil has inevitably involved the development of some industrial skills, despite the large input by expatriates.<sup>2</sup> The question still remains: How can this extensive industrialisation be achieved? In the initial aftermath of the increases in revenues in the early 1970's the Saudis had tentative plans for a whole range of industries - from refining and petrochemicals to steel and aluminium processing. Gradually, these plans were whittled down to a realistic core. For example, the car assembly plan was discouraged because it was labour intensive. Nevertheless, the remaining plans are ambitious, especially for a relatively unsophisticated economy.

Even today Saudi Arabia has to import many petroleum based products which cannot be produced by the country's own refinery plants. Unfortunately, however, local multiplier effects from establishing

refineries to produce imports substitutes are minimal. This type of industry is by nature highly capital intensive and creates few employment opportunities. The majority of the more highly skilled workforces are expatriates, who remit a substantial part of their salaries to their home countries, while their local consumption is usually not from imported goods. The absence of trained nationals acts as a limitation on import substitution in Saudi Arabia so this is discussed in the next chapter.<sup>3</sup> Below, we look at import substitution policies in the First and Second Plans.

Shaw and Long state that the First Five Year Plan contained the three primary goals: "maintaining the fundamental religious and social values of the Kingdom, increasing its defensive capability, and preparing the economic diversification in the post-oil era".<sup>4</sup> The high dependency of the economy on oil, and the high propensity to import in Saudi Arabia, means that economic diversification goes hand in hand with import substitution policies. Successful diversification away from oil necessarily implies the implementation of import substitution policies. Initially, under the First Plan, preparations for economic diversification were constrained by financial considerations. However, as the Third Development Plan states, the most outstanding feature of the First Plan period was "the complete change in the rate of obtaining revenues from oil, and the degree of control over the Kingdom's oil resources".<sup>5</sup> Hence, during the later years of the First Plan, finance ceased to be the main constraint. Yet, other factors continued to limit development.

The First Plan was cautious but also flexible. It allowed the continual revision of budgets upwards throughout the five years with a paucity of educated technocrats, an inadequate data base, and no bureaucratic tradition, the government launched an accelerated effort to achieve the ambitious goals contained in the Second Plan. They included massive physical infrastructure projects - roads, ports, airports, industrial estates, and the beginning of industrial zones and far reaching social programmes. All these represent good preparations for economic diversification. The development plan effort was surprisingly successful in constructing physical infrastructure, and it set a firm foundation of education and other social institutions. Furthermore, the administrative inefficiencies of the government bureaucracy actually served to buffer against the social discrimination of the development process by impeding rapid implementation of so many major projects.<sup>6</sup>

Import substitution policies were more prominent in the Second Plan but still they were only indirectly followed by the Saudi Government. According to the Third Development Plan, the strategy of the Second Plan concentrated on four main areas for development. One of the four areas was the private sector. Private enterprise was given a major role in the development of the productive sectors and assured all possible government assistance and financial stimulation.<sup>7</sup> This means the non-oil related industries have been, and are being, encouraged. In this sector the objectives stated by the Saudi government include: 1) to increase the domestic economy's capacity to produce at competitive costs a wide range of products for domestic as well as for the export markets, 2) the industrial exploitation of the substantial comparative advantages arising from low

cost energy and other natural advantages, 3) furthering the Kingdom's access to modern technology, 4) to encourage the use of the capacity of the private manufacturing sector, 5) to increase productivity through careful adherence to a policy of "optimal size" of plants, 6) to secure a regional and balanced development of industry and, 7) to reduce dependence on expatriate workers by national skill creation.<sup>8</sup>

From 1976 to 1980 Saudi Arabia experienced a 15 per cent growth rate annually in the general development of the non-hydrocarbon manufacturing sector which exceeded the planning targets. The hydrocarbon-based projects, in spite of many obstacles, are often incredible range of their targets for the Second Plan. The rapid transformation of Saudi cultural life may indeed dictate the incorporation of additional delays beyond those indicated within the planning process. However, that elongation may prove to be a significant asset in their orderly implementation.

Half a decade later in 1980, the same goal of diversification remained one of the fundamental objectives for the long-term economic development of the Kingdom and a key aspect of the strategy for the 1980-85 period. The private sector is still to be encouraged to participate in capital investments. Only where the size of investments is large and beyond the capacity of private individuals, will the government itself undertake capital investment. The productive sectors, including agriculture, industry and mining are to be emphasised, with the development to be primarily undertaken by the private sector. The government's role is to be a supportive one. The aim being to create a favourable environment where private business can prosper.

This support is to take the form of providing information on the opportunities for investment in the productive sectors of the economy. The information is expected to accrue from increased emphasis on economic feasibility studies and programmes of applied research. Further government support will come from the completion of infrastructure and the provision of services related to maintenance, marketing and transport where needed to support productive industries. In particular, two areas were seen as crucial for investment by the private sector. That is, large scale mechanised agricultural projects and, projects which introduce appropriate, new economic technologies. Both are seen as essential for the implementation of import substitution policies. It is worth noting that there are certain indications to suggest that planners are beginning to adopt a regional approach. The number of projects involved are small at present and they are only between Bahrain, Kuwait and Saudi Arabia. Economists suggest that planners are acting rationally and observing the Gulf through remarkably un-nationalistic eyes. Others suggest it is more of a case of not putting all their 'eggs in one basket', that is, Saudi Arabia.<sup>9</sup>

However, as a result of the rapid economic growth, the Kingdom's total value of imports rose dramatically, as discussed in Chapter 2. Over the period 1973-78, imports increased by an average annual figure of 58.2 per cent, reaching the amount of SR 69,180 million in the latter year. This high propensity to import is expected to be maintained in the Third Plan period as well. Perhaps this points to a paradox in the Saudi plans. By encouraging the economic diversification of the non-oil sector with the long-term strategy of successful implementation of import substitution

policies, the propensity to import may increase as more goods are demanded to support such policies. The evidence in the last chapter does not support this it indicated that capital investment is not necessarily associated with increasing imports. Nevertheless, Saudi planners are still faced with the dilemma that import substitution cannot be achieved in the short-term. They have to be content with preparing the ground for import substitution policies. In fact, the intentions of the planners were for the import growth rate to stabilise at about 7 per cent per annum. Import composition for the five year span was expected to be influenced by a rise in components and products substituting for labour.

Third Plan projections are for the petroleum sector to grow by only 1.3 per cent per annum while the non-oil sectors will expand by a large (but more modest than in the Second Plan) rate of 6.2 per cent. In practice, there is evidence of a lower rate of growth for oil and a higher rate for the non-oil private output in the Third Plan in comparison with the Second. However, oil continues to dominate the economy. Yet, diversification efforts as provided in the Second and Third Plans have begun to bear fruit. Opportunities for business in the non-oil private sector are thus likely to grow in the foreseeable future. A noteworthy development pertaining to Saudi business opportunities which was expressed in the Third Plan involves the concept of 'Saudization'. This principle provides for priority in the awarding of tenders to be given to Saudi contractors. When contracts are awarded to foreign contractors there will be a stipulation that some of the work must be sub-contracted to Saudi companies. In order to facilitate the policy, it is intended that very large projects should be split up rather than awarded as a single

package.<sup>10</sup> Foreign participation in the import substitution process will be looked at specifically in 3.3.

### 3.2 PATTERN OF IMPORT SUBSTITUTION

It must firstly be said that licensing is obligatory for new or joint industrial projects. Saudi firms which expect to seek government protection and assistance must also be licensed. Government licensing assures that the projects will contribute to plan fulfillment.<sup>11</sup> Therefore, a fair assessment of the pattern of import substitution or economic diversification can be obtained. In this case, the industrial licenses issued in 1975, 1976 and 1977 give a good indication as to what was happening during the Second Development Plan. In this period 1,035 licenses were issued and table 3.1 shows the percentage of total licenses issued by economic activity. The figures quoted were calculated from the absolute figures cited in the Saudi Arabian Monetary Agency (SAMA) 1979 Annual Report.

Column 1 of table 3.1 shows very clearly that the most industrial licenses were issued in the category of the manufacture of non metal goods. In fact, 49.37% of the total licenses were issued in this sector. This sector includes petrochemicals, rubber and plastics, all kinds of non metal pipes, general construction materials, china and glassware. By looking at the industrial licenses it could be said that in general the Saudi Government has managed to diversify most successfully away from oil in the manufacture of goods, relating to the construction industry.

Table 3.1

Investment by Economic Activity in Saudi Arabia in 1975, 1976 and 1977

Kind of Economic Activity	Percentage of total industrial licenses by economic activity	Percentage of authorised capital (local and foreign) by economic activity	Percentage of paid up capital (K) by economic activity	Ratio of paid up K to authorised K by economic activity
Beverages/Foodstuffs	17.78	14.35	13.39	.39
Manufacture of materials, e.g. products of paper pulp	8.12	5.27	5.99	.47
Manufacture of non metal products, e.g. cement, lime, plastic and marble	49.37	61.09	64.78	.44
Manufacture of metals, e.g. structural metal products	24.44	19.14	15.54	.33
Other products	0.29	0.16	0.30	.79

Source: Saudi Arabian Monetary Agency, Annual Report, 1979. Table 36, p. 75. Proportions calculated by the author.

The second highest number of licenses were issued in the manufacture of metals category. 24.44% of total licenses were issued for goods structured in metal. These included goods such as steel hangers, central air conditioning ducting and aluminium doors and windows. Goods in this category supply both the domestic and industrial markets. Many of the goods for which licenses have been issued in this category can be made with non-sophisticated machinery and without specialised manpower. This perhaps accounts for the relative dominance of this category. On the other hand, quite a high proportion of licenses (17.78%) were issued in the beverages/foodstuffs category. Yet this could be considered quite low, given the large number of people working in the rural sector in Saudi Arabia.

Columns 2 and 3 of table 3.1 show the percentage of investment by economic activity. Column 2 looks at "total capital" or authorised capital, and column 3, "paid up" capital which could be seen as the initial investment with a view to a firm growing in the future. Again, the outstanding category is the manufacture of non metal products. 61.09% of the total of total capital and 64.78% of the total of paid up category was accounted for in this way. Apparently, investors see this area worthy of investment which is in line with the idea that there will continue to be a demand for such goods. Cement, for example, will be needed for future construction projects. Not altogether surprisingly, Column 1 (industrial licenses issued) and columns 2 and 3 show similar results. This is not the case for the manufacture of metals. It accounts for 24.44% of the licenses (253) but only for 19.4% and 15.54% of authorised capital and paid up capital, respectively. This may mean that establishments in this category are less capital intensive. Or, this may suggest a lessening of confidence

for a continued demand for products in this category. Alternatively, it may reflect the high proportion of investment in the non metal category. This could also be the case for the category, manufacture of materials.

The ratio of paid up capital to authorised capital in table 3.1 has been calculated by dividing paid up capital by authorised capital. It should, therefore, provide a rough comparison of capital already invested and the future ambitions of a firm (total capital). The most notable is the "other products" from the SAMA table which includes all goods not classified in the first few categories of table 3.1. There is a high ratio of 0.79 in this category suggesting firms were achieving their ambitions to a large extent. However, this category only accounts for 3 of the 1,035 licenses issued, hence no general conclusions should be drawn. There is not a very significant difference in the ratios of the other categories. The lowest ratio was achieved by the manufacture of metals category, 0.33, suggesting firms in this category have plenty of room for expansion.

Table 3.2 presents the same information for 1981 and 1982 which can be seen as an indication of what is happening under the Third Development Plan. This table has been calculated directly from the quarterly lists of licensed factories and industrial licenses issued by the Kingdom of Saudi Arabia's Ministry of Industry and Electricity, the Industrial Affairs Agency and the Industrial Statistics Department in 1981 and 1982. This has allowed a further breakdown of categories so that table 3.1's manufacture of metals category has been broken down into the manufacture of metals, the manufacture of durable goods and transport goods in 3.2. In 1981 and 1982 a total of 634 licenses were issued. Again, the first column of table 3.2

shows the percentage of total licenses issued by economic activity. This column shows quite a lot of similarities with 3.1

Once more, the highest percentage of licenses were issued in the manufacture of non metal products category, 41.64% compared with 49.37% in table 3.1. As stated above, in general the licenses issued in this category are for goods used in the construction industry. Economic diversification in this category would appear rational, given the heavy transport costs involved in the movement of bulky goods. However, although this category has retained its primary position, it is to a lesser extent. Why? The Second Development Plan gave a far greater emphasis on infrastructural projects than the Third Development Plan which instead emphasised selective economic diversification. That is, development in sectors where Saudi Arabia might have a comparative advantage.

When the categories of the manufacture of metals, the manufacture of durable goods and transport goods are combined, a percentage of 28.24% is achieved. This compares with 24.44% in table 3.1 suggesting this category has become more important. Certainly, more licenses have been issued for durable goods and transport goods in 1981 and 1982 than in 1975, 1976 and 1977. This could suggest that the Saudi Government has now begun to lay the foundations of economic diversification by its policies under the Third Development Plan. There is also a marked change in the number of licenses accounted for in the category of beverages/foodstuffs. In 1981 and 1982 this category accounted for 12.18% of the total (77 of 634), compared with 17.18% in 1975, 1976 and 1977 (184 of 1,035). This decrease could be

Table 3.2

Investment by Economic Activity in Saudi Arabia in 1981 and 1982

Kind of economic Activity	Percentage of total industrial licenses by economic activity	Percentage of authorised capital (local and foreign) by economic activity	Percentage of paid up capital (K) by economic activity	Ratio of paid up K to authorised K by economic activity
Beverages/Foodstuffs	12.15	3.21	2.59	.26
Manufacture of materials, e.g. products of paper pulp	17.51	6.56	4.60	.23
Manufacture of non metal products, e.g. cement, lime, plastic and marble	41.64	82.06	84.75	.34
Manufacture of metals e.g. structural metal products	19.56	5.50	5.57	.33
Manufacture of durable goods, e.g. electrical industrial machinery	5.21	1.70	1.63	.31
Transport goods	3.47	0.87	0.69	.26
Not elsewhere classified	0.47	0.11	0.17	.54

Source: Compiled and calculated by the author from the quarterly lists of licensed factories and industrial licenses issued by the Kingdom of Saudi Arabia, Ministry of Industry and Electricity, Industrial Affairs Agency, Industrial Statistics Department in 1981 and 1982.

accounted for by the growth of other categories, rather than an actual restriction in the foodstuffs/beverages category.

Columns 2 and 3 of table 3.2, like table 3.1, show the percentage of total capital and the percentage of paid up capital by economic activity, respectively. A similar result is achieved. Columns 2 and 3 are more or less consistent for the manufacture of metals, however, as both total and paid up capital account for more than 80% of their totals. Obviously, there has been very heavy investment in the manufacture of non metals category. This suggests that investors see a promising future in the construction industry and, perhaps a certain amount of success in the Government's import substitution policies. Bearing in mind that table 3.1 accounts for 3 years and table 3.2 for 2 years, the totals for authorised capital relating to table 3.1 is 10,249.6 and table SR 3.2 34,493.3 million. A great deal more capital has been invested under the Third Development Plan. Overall, SR 6,951.1 million was the total paid up capital in the period relating to table 3.1, compared to SR 13, 684.42 million in the period relating to table 3.2.

Due to the heavy investments in manufactures of the non metal category, percentages relating to the remaining categories look less significant. They do show, however, a marked increase in investment relative to 3.1. For example, only 4.6% of paid up capital was achieved by the manufacture of materials category. Yet, this accounts for SR 629.78 million, compared to SR 414.2 million for the 3 years under table 3.1. However, the situation is reversed for the category beverages/foodstuffs. The total paid up capital invested in table 3.1 and 3.2 is SR 927.5 and SR

353.77 million respectively. In this category there has been a marked drop in investment.

It appears that table 3.2 reflects a marked shift in capital investment away from sectors like food/beverages and heavy investment in the industrial sector - and the construction industry in particular. The Government seems to have achieved some success in its policies to encourage private sector participation which is shown clearly in the total capital invested. The question of just how much of this investment was Saudi investment, and how much was foreign investment, will be discussed in the next section.

The ratio of paid up capital to authorised capital by economic activity is calculated by dividing paid up capital by authorised capital, as in table 3.1. The data for 1981 and 1982 gave much lower ratios. Nonetheless, with the exception of the not elsewhere classified section, the ratios within this period were not dissimilar. The highest ratio was again achieved by the manufacture of non metal category but only by 0.01 (0.33 was achieved by the manufacture of metals category). Perhaps overall, the ratios might suggest growth for the firms in the future.

Circumstances in the early years helped to promote the Government's long term aim of import substitution. The Government provided services, plots in industrial states, cheap power and inexpensive finance. Private Saudi firms also benefitted from the appalling delays in landing goods in 1976-77 because of port congestion. In the years 1975, 1976 and 1977 over 600 new industrial plants were initiated. As a result of this growth,

Saudi Arabia is now virtually self-sufficient in the principal building materials: production of cement, clay, concrete and sand lime bricks, tiles, aggregate precast concrete and prefabrication systems, doors, windows and a number of other items. The same applies to screws, scaffolding, fencing and insulation materials. As stated above, the bulky nature of such products make them obvious choices for local production. More recently, emphasis has been placed on consumer goods, as well. Household goods like detergents, and furniture and household appliances like refrigerators, all contribute to lessen the dependence for importation items of consumption.

The future for the private sector looks promising but many difficulties must be overcome. Reliable statistics on current output, investment, employment and industrial capacity are not available and this is at least unhelpful. Government machinery operates weakly and sometimes as an obstacle. Few government employees are familiar with the characteristics and problems of industry. Another problem is that nearly all planning activity is centralized in Riyadh with a consequent limiting effect on the planners' perspectives. This reflects the historical policy of not allowing local government and private interest groups to become strong, rather than a fault in the planners' approach.

Finally, "the limited size of the market makes it difficult to foresee a long vigorous growth in import substitution projects, since many of the available sectors, particularly in building materials, are now in a supply-demand equilibrium".<sup>12</sup> Opportunities do exist in foodstuffs, plastics, chemicals and metal working. It is argued (and this will be discussed

later in the thesis) that increasing attention must be focused on export possibilities using feedstock from the large petrochemical plants planned for Yenbo and Jubail. The extent to which downstream export facilities will be erected depends on the government approach. By maintaining a cheap capital and energy supply, and by subsidising the necessary raw materials, many possibilities will undoubtedly present themselves.

### 3.3 FOREIGN PARTICIPATION IN THE IMPORT SUBSTITUTION PROCESS

As table 3.3 shows, 226 industrial licenses were issued to projects with foreign participation in the years 1975, 1976 and 1977. Table 3.3 is compiled and calculated from the industrial licenses published by the Saudi Ministry of Planning by the author. It shows that of the 226 issued, 76 were issued to nationals of other Arab countries and 150 to non Arab nationals. When the table is examined in terms of economic activity, the manufacture of non metals category is again predominant. More than 40% of the total of industrial licenses issued with foreign participation were issued in this category showing the dominant position of the construction and construction-related industries again. Table 3.3 also shows the predominant position of West European nationals for this category. 51 of these 104 licenses included participation by West European nationals, 25 to other Arab nationals, and 17 to the United States.

The second most important category is the manufacture of metals, as with the total number of industrial licenses issued (local and foreign). 56 licenses were issued in this category. 25 of these licenses were issued to projects with West European participation, 21 to other Arab countries

Table 3.3

## Foreign Investment according to Industrial Licenses issued in 1975, 1976 and 1977

Kind of Economic Activity	Number of Industrial Licenses issued to ventures with foreign investment by economic activity	Number of Industrial Licenses issued according to nation by economic activity		Average Percentage of foreign capital share in ventures by economic activity	Range of Percentage of foreign capital share in ventures by economic activity	
		ARAB	NON ARAB		LOWEST	HIGHEST
Beverages/Foodstuffs	20	10	W. Europe 5 U.S.A. 2 Canada 1 Australia 1 Hong Kong 1	41.12	5	66.65
Manufacture of materials, e.g. products of paper pulp	13	8	W. Europe 3 Asia 2	49.94	20	100.00
Manufacture of non metal products, e.g. cement, lime, plastic and marble	104	25	W. Europe 51 U.S.A. 17 Canada 2 Asia 4 Other Americas 2 Other 3	43.79	10	100.00
Manufacture of metals, e.g. structural metal products	56	21	W. Europe 25 U.S.A. 4 Asia 3 Iran 2 Other 1	47.85	7.8	100.00
Manufacture of durable goods, e.g. electrical machinery and equipment	33	12	W. Europe 12 U.S.A. 6 Asia 2 Iran 1	48.49	15	100.00

Source: Compiled and calculated by the author from the quarterly lists of licensed factories, and industrial licenses issued by the Kingdom of Saudi Arabia, Ministry of Industry and Electricity, Industrial Affairs Agency, Industrial Statistics Department in 1975, 1976 and 1977.

and only 4 per cent to the U.S.A. Overall, when table 3.3 is examined in terms of which countries have participated to the greatest extent, western Europe is most important for each category. In terms of a single country, the U.S.A. holds the primary position. 29 industrial licenses were issued with American participation. In general, the U.S.A. is involved with the high technology, capital intensive projects, like the manufacture of plastics. The Europeans major input appears to be in the construction and construction related industries.

Column 4 of table 3.3 which shows the percentage of foreign capital share in ventures has been calculated simply by adding the percentage of foreign participation in ventures in each category and dividing by the number in that category. In general, the average percentage of capital shares in ventures in 1975, 1976 and 1977 is similar in each category. The manufacture of materials category provides the highest average percentage of foreign capital share, 49.94. There is, however, little foreign participation in this category. The lowest percentage is 20% so this is perhaps not a significant result. The lowest average percentage of foreign capital share in ventures is in the beverages/foodstuffs category, 41.12%. Again, this probably reflects the small range. The highest for beverages/foodstuffs is only 66.65% (and it is 100% for the other categories).

Authorised capital investment by foreign investors in 1975, 1976 and 1977 (table 3.4) was calculated by adding up the authorised capital invested by foreign countries in each category and dividing by the number in that category. The highest average authorised capital investment is

Table 3.4

Foreign Investment according to Industrial Licenses issued in 1975, 1976 and 1977 by Authorised Capital Investment

Kind of Economic Activity	Capital Investment by foreign countries according to Economic Activity in million riyals		
	AVERAGE	LOWEST	HIGHEST
Beverages/Foodstuffs	21.71	2.2	120.2
Manufacture of materials e.g. products of paper pulp	8.32	1.5	20
Manufacture of non metal products, e.g. cement, lime, plastic and marble	7.27	1.28	117.63
Manufacture of metals e.g. structural metal products	24.19	0.3	322.67
Manufacture of durable goods, e.g. electrical industrial machinery and equipment	18.97	0.96	140.8

Source: Compiled and calculated by the author from the quarterly lists of licensed factories, and industrial licenses issued by the Kingdom of Saudi Arabia, Ministry of Industry and Electricity, Industrial Affairs Agency, Industrial Statistics Department in 1975, 1976 and 1977.

achieved by the manufacture of metals category, 24.19. There is a very large range of authorised capital investment in this category - varying between 0.3 million riyals and SR 322.67 million. The highest was achieved by a firm producing steel bars with Luxembourg as the foreign participator. The second highest average is achieved by the foodstuffs/beverages category: SR 21.71 million. The venture with the highest authorised capital investment of 120.2 million has a 30% Lebanese participation and was issued in 1976. The smallest average is achieved by the non metal product category: only SR 7.27 million. Authorised capital investment in this category varies a great deal.

Table 3.5 shows a marked decrease in foreign participation under the Third Development Plan, compared to the Second Plan. Only 93 industrial licenses were issued to ventures with foreign participation in 1981 and 1982, compared to 226 for the 3 years of 1975, 1976 and 1977. Although table 3.5 only accounts for 2 years compared to 3 years in table 3.3, this factor is insufficient to account for such a marked decrease. This is perhaps a reflection of concept of 'Saudization' expressed in the Third Plan. This principle provides for priority in the awarding of contracts to Saudi contractors. When contracts are awarded to foreign contractors, there is a stipulation that some of the work must be sub-contracted to Saudi companies. In order to facilitate this policy, it is intended that very large projects should be split up rather than awarded as single package,<sup>13</sup> as already stated in chapter 2.

When table 3.5 is examined in terms of economic activity, as with table 3.3, the manufacture of non metal category dominates: 44 industrial

Table 3.5

## Foreign Investment according to Industrial licenses issued in 1981 and 1982

Kind of Economic Activity	Number of Industrial Licenses issued to ventures with foreign investment by economic activity	Number of Industrial Licenses issued according to nation by economic activity		Average Percentage of foreign capital share in ventures by economic activity	Range of Percentage of foreign capital share in ventures by economic activity	
		ARAB	NON ARAB		LOWEST	HIGHEST
Beverages/Foodstuffs	4	None	W. Europe 3 Other 1	35.4	20	49
Manufacture of materials, e.g. products of paper pulp	10	6	U.S.A. 1 W. Europe 1 Asia 2	54.2	33	100
Manufacture of non metal products, e.g. cement, lime, plastic and marble	44	5	U.S.A. 7 W. Europe 18 Asia 6 Other Americas 9	47.9	15	75
Manufacture of metals, e.g. structural metal products	25	14	U.S.A. 3 W. Europe 4 Asia 3 Other 1	45.4	16	100
Manufacture of durable goods, e.g. electrical industrial machinery and equipment	10	3	U.S.A. 1 W. Europe 4 Asia 1 Other Americas 1	45.7	25	70

Source: Compiled and calculated by the author from the quarterly lists of licensed factories and industrial licenses issued by the Kingdom of Saudi Arabia, Ministry of Industry and Electricity, Industrial Affairs Agency, Industrial Statistics Department in 1981 and 1982.

licenses were issued to ventures with foreign investment. In this category West European countries accounted for 18 licenses, other Americas (Cayman Islands, Argentina) 9, U.S.A. 7. As in table 3.3, the second largest category for foreign investment is the manufacture of metals category for 25 licenses. Although the number of industrial licenses issued in each category is much lower in 1981 and 1982, the categories have generally retained their order of significance. Additionally, the countries involved in foreign investment have also kept their position of importance. West European countries account for 30 industrial licenses, Arab countries for 28 licenses and the United States for 12.

Column 4 of table 3.5 shows the average percentage of foreign capital share in 1981 and 1982 in ventures by economic activity. This varies between 35.4% and 54.2%. Unlike the years 1975, 1976 and 1977, there is foreign dominance in this category of manufacture of materials. However, there are only a total of 10 licenses issued in this category and 6 of these were issued to other Arab countries. This result is therefore not of great significance. Besides, the range of percentage of foreign capital share in this category is not great (33 to 100). The lowest average is found in the beverages/ foodstuffs category, but only 4 licenses were issued in this category. Also, the highest is only 49% which is much lower than the other categories.

Table 3.6 authorised capital investment by foreign investors was calculated by the same method used in table 3.4. The results were quite different. Emphatically, the highest average of authorised capital investment is found in the category, manufacture of non metals. The

Table 3.6

Foreign Investment according to Industrial Licenses issued in 1981 and 1982 by authorised capital investment

Kind of Economic Activity	Capital investment by foreign countries according to Economic Activity in million riyals		
	AVERAGE	LOWEST	HIGHEST
Beverages/Foodstuffs	38.85	15.9	69.72
Manufacture of materials e.g. products of paper pulp	30.17	1.99	136.0
Manufacture of non metal products, e.g. cement, lime, plastic and marble	824.41	1.27	8,303.0
Manufacture of metals e.g. structural metal products	16.70	1.50	100.0
Manufacture of durable goods, e.g. electrical industrial machinery and equipment	20.91	5.1	50.0

Source: Compiled and calculated by the author from the quarterly lists of licensed factories and industrial licenses issued by the Kingdom of Saudi Arabia, Ministry of Industry and Electricity, Industrial Affairs Agency, Industrial Statistics Department in 1981 and 1982.

highest 'authorised capital' for a single project is achieved by Panama in 1982, SR 8,303.3 million. The industrial activity is listed as petroleum refineries. Products include naphtha, jet aircraft fuel, fuel oil and sulphur. It is disappointing to find this heavy investment is in an oil related industry. Also, some Panama owned ventures may merely represent holding companies with substantial Saudi participation. Therefore, it is not pure foreign investment.

The second highest average authorised capital investment is found in the beverages/foodstuffs category. The average here is SR 38.85 million. The lowest and highest authorised capital investment is SR 15.9 and SR 69.72 million, respectively. The industrial activity for the highest is cited as soft drinks and carbonated water industries and the country is Italy with 49% share. Only 14 licenses were issues in this category so the results cannot be seen as very significant.

It is worth noting that the category with the lowest average authorised capital investment is the manufacture of metals. This is the category with the highest average authorised capital investment in 1975, 1976 and 1977. The years 1981 and 1982 show heavy investment in the construction related industries.

Although there appears to have been a marked decline in foreign participation under the Third Plan, it still has a major role to play. It has been stated above that there has not been a shortage of capital in Saudi Arabia for almost a decade. Then why should the Government encourage foreign participation at all in Saudi Arabia? In part, the answer can be

found in Saudi Arabia's industrial strategy. Closer attention is being given to the selection of new technology and the means of incorporating the existing technology. The Saudi Government is interested in the transfer of technology, not only internally between various industries and scientific research, but also internationally from similar institutions in other countries. By encouraging foreign participation, the successful transfer of technology may be achieved.

The value of the transfer of technology can be seen when it is accepted that industrialisation is achieved not only through production but also through the development of national design and application capability. Among the major obstacles that the Saudis have had to overcome in their attempt to absorb new technology are 1) lack of industrial infrastructure and an industrial tradition, 2) lack of skilled manpower and, 3) the reluctance of many foreign companies to co-operate sincerely in the transfer of technology. This has meant that the government has not relied on foreign participation alone for the transfer of technology. It is recognised that sustained growth of the technological base is almost directly correlated to the quantity and quality of research and development work. As a consequence, the government has been investing heavily in its institutions of higher education and also, establishing a data base.

It is too early to determine whether the government has begun to implement its import substitution policies successfully, especially on the basis of data presented in this chapter which only covers particular years between 1975 and 1982. In any case, it could be said that the country is going through an experimental period. The Kingdom must determine what the

future of its oil and gas sector is and continue to scrutinise its policies of diversification. An industrial culture takes time to build up. Perhaps it is questionable whether it is worth developing industries that have to be run by expatriates. This may lead to loss of Saudi culture which the Saudi authorities are trying to protect. Saudis in general appear disinterested in learning manufacturing skills. (It is to be remembered that it is less than a decade since the planners had sufficient financial resources to encourage the manufacturing sector and for the labour force to adopt new attitudes.) If this is the case, perhaps Saudi strategy should be to develop a limited range of capital intensive hydro carbon processing industries. In other words, they should leave the labour intensive industries to other countries.<sup>14</sup>

In fact, the government has been careful to encourage industries and techniques of production which are suited to its factor endowments. In terms of import substitution policies, this has meant investing in industries like cement and steel manufacturing. The petrochemical industry is encouraged with the aim of diversifying exports. Labour problems in industrialised countries prevent the innovation of capital intensive and efficient techniques but this is not a problem for Saudi Arabia. The Kingdom can therefore make use of the most up to date technology and use foreign manpower. In the longer term, the resulting dependence on oil revenues is a weakness. Consequently, one of the major objectives of the Third Plan is the upgrading of human resources, as described in the next Chapter.

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## CHAPTER 4

MANPOWER CONSTRAINTS ON IMPORT SUBSTITUTION

The subject under consideration in Chapter 4 is the role of the labour force. Throughout this thesis Saudi Arabia's economic diversification policies are being evaluated. It has emerged that Saudi Arabia is dependent on imports to a large extent, so continually the question is being asked: how successful have the import substitution policies been? In particular, this chapter looks at the extent to which the labour force has limited the success of those policies.

The Saudi Government, as the central planning body, has experienced numerous problems in diversifying its domestic economy. Growing oil revenues have meant that financing development has not been a problem, although by 1983 there were clear signs of this situation changing. Previously, one of the problems has been to limit development to within the capabilities of the current structures. During the 1970's the absence of a stable infrastructure slowed-down development but under the extensive projects of the Second Plan, problems like bottlenecks at ports have more or less been removed. It was also thought that the absorptive capacity of the economy would be inadequate. Chapter 2 gave evidence to suggest this is not a problem.

Much success was achieved in the 1970's. The growth rate of the economy has been impressive but it has only been achieved by the use of foreign manpower. In some sectors, for example in the basic metals sector,

more than 95 per cent of the workforce has been non-Saudi. More than 25 per cent of the total labour force has been non-Saudi. There has been a high dependency on foreign labour which has caused concern. By 1980 a two-tier labour force had emerged: a modern sector and a traditional sector with non-Saudis prevalent in the modern sector. Foreigners apparently dominate the Government revenue producing sector, despite the earlier nationalisation of the oil companies. The situation also looked unsatisfactory because of the potential economic and political dangers of having so many foreigners in the country at the same time. As a result, the Third Plan attempts to consolidate the non-Saudi workers at the 1980 level.

#### 4.1 EMPLOYMENT POLICIES UNDER THE THIRD PLAN

"The policy area with the most far reaching quantitative and qualitative changes in the Third Plan period is that relating to manpower and employment".<sup>1</sup>

The economic development strategy of the Third Development Plan is based on the same three key objectives which directed the Second Plan. These objectives are 1) Diversification of the economic base, 2) Development of the Kingdom's manpower resources, and 3) A balanced pattern of economic growth. That is, growth which ensures the development of all regions, benefits to all sectors of the community and, supports individual effort and achievement. Not surprisingly, all three objectives are essential to any discussion of the role of the labour force. As stated, in Chapter 3, almost any diversification of the economic base represents successful

implementation of import substitution policies such as the importance and dominance of imports in the Saudi economy. However, in the Third Plan, the growth objectives are more selective than under the Second Plan. The manpower policy aims at consolidating the size of the foreign labour force. By utilising the infrastructure facilities created in the Second Plan, the Third Plan makes further progress towards diversifying the economy in the direction of capital intensive development. This approach is seen as the best, long term combination of the Kingdom's capital and labour resources. Another feature of the Third Plan is the policy requiring new employment to correspond as closely as possible to the domestic availability of new Saudi manpower. This represents a constraint on the growth target. The total number of non-Saudi labour force, which has always been under administrative control through a system of work permits, is being consolidated at about its 1980 size. However, its skill composition will be kept flexible to meet any priority demands for special skills and expertise.

The selective changes of emphasis for sectoral growth will be obtained by smooth transition rather than abrupt change, in accordance with the Plan strategy of economic diversification and of giving priority to the development of the producing sectors. The main trends in the Third Plan will be for a substantial part of the new investment to promote higher value production and diversification in the oil sector and in those industries where there is a clear comparative advantage. The latter usually relates to those which are energy-intensive. Again, the constraint on foreign manpower will reduce the scope for growth through increased employment. These considerations indicate that the economy will enter a

period of structural transformation which may last longer than the Third Plan itself. Despite the constraint on manpower, the results of increased capital efficiency should become evident during the Third Plan period in the form of higher productivity. However, higher productivity within sectors of the non-oil economy will depend largely on the private sector's willingness to direct its autonomous growth from the areas of easy profit making. That is, whether they move from areas such as property development and trade to more competitive branches of activity with a better potential for long term growth.

Ironically, the Government's recognition of the need for Saudi nationals to participate to the fullest extent in the development of the economy, has meant that labour is even more scarce in the short term. The Government has allocated 18.5 per cent of its total expenditure on development under the Third Plan to "human resource development". This represents SR 129.6 billion.<sup>2</sup> Members of the workforce are being trained and educated instead of being available for work. Although education and training are essential, if Saudis are going to participate in the modern sector, their temporary absence has made the short term situation more difficult.

Such are the aims of the Third Plan. However, there are signs that they will not be fully implemented. The Saudi Finance Ministry assumes a severe drop of more than 28% in its Budget revenue 1983/84.<sup>3</sup> This follows a smaller decreases in previous years. The 1983/84 decrease is a result of the forecast cut in oil production and associated revenues. Other income earning sectors are expected to show a rise, as table 4.1 shows.

Table 4.1

Expected 1983/84 Budget Revenue By  
Source and Per Cent Changes from 1982/83

(SR mn)

	<u>Revenue</u>	<u>% Change</u>
Oil Production	37,680	-37.9
Income tax	113,830	-43.4
Oil firms' profits	6,986	-20.1
Oil products tax	6,000	50.0
Customs duties	5,300	33.3
Service fees	730	29.9
PTT & telex	6,500	37.5
Government sales	100	-31.0
Rents & instalments	617	48.3
Zakat	400	23.4
Miscellaneous	47,075	19.3
TOTAL	225,218	-28.2

Source: Quarterly Economic Review of Saudi Arabia. The Economist Intelligent Unit 1983, p. 14.

Table 4.2  
Saudi Arabian Budgets 1982/83 and  
1983/84: Expenditure Allocations by Sector

(SR mm)

<u>Sectoral Totals</u>	<u>1982/83</u>	<u>1983/84</u>	<u>%</u> <u>Change</u>
Defence & security	92,889	75,733	-18.5
Manpower development	31,864	27,791	-12.8
Transport & communications	32,533	24,950	-23.3
Health & Social development	17,011	13,591	-20.1
Economic Resources	22,045	13,209	-40.1
Infrastructure	11,705	9,583	-18.1
Municipal services	26,224	19,070	-27.3
Credit institutions	23,382	20,000	-14.5
Domestic Subsidies	11,162	9,020	-19.2
Public administration & government services	9,480 <sup>a</sup>	47,053 <sup>a</sup>	.....
Miscellaneous	35,106 <sup>a</sup>	-a	.....
<b>TOTAL</b>	<b>313,400</b>	<b>260,000</b>	<b>-17.0</b>

a Reclassification changes.

Source: Quarterly Economic Review of Saudi Arabia, The Economist Intelligent Unit 1983, p. 16.

The result has been a 17 per cent cut in budget expenditure to match a considerable portion of the expected fall in revenue. What the situation will be in 1985 is largely dependent on forces outside Saudi Arabia's control. Two factors are crucial: the degree to which demand for oil picks up as the predicted 'world economic recovery' proceeds, and the proportion of the hoped for increase in demand which Saudi Arabia and OPEC can supply. Table 4.2 shows the extent to which manpower development will be affected. Compared to other sectors it is relatively lightly affected with a 12.8 per cent drop in its expenditure.

#### 4.2 MANPOWER PROJECTIONS FOR 1980 - 1984

Civilian employment is expected to increase from 2.47 million in 1979/80 to 2.63 million in 1984/85,<sup>4</sup> as table 4.3 shows. To arrive at these estimates projections were made concerning the growth of the Saudi labour force, labour supply and demand, employment structure, and productivity. Projection of these variables is difficult and the subject is continuously under review, in case it proves necessary to re-evaluate the policies. The following is a detailed review of the individual aspects, as outlined in the Third Plan. Firstly, the growth of the Saudi labour force. The proportion of Saudi males (12 years of age and above) participating in the labour force will continue to register a slight decline, from 65.3 to 64.1 per cent over the expansion of education and training programmes. This "schooling factor" will influence, in particular, the participation rate of the 12-19 age group. The decline of the participation rate among this age group is the cost of investment in society's future development, the opportunity cost in economic terms.

Table 4.3

Projected Civilian Employment in Saudi Arabia 1979/80 and 1984/85

	Civilian Employment		Net Change	Annual Growth Rate
	<u>1979/1980</u>	<u>1984/1985</u> (Thousands)		<u>1979/1980 to 1984/1985</u> (Per cent)
Saudi men	1,308.4	1,437.4	129.0	1.9
Non Saudi men	1,014.9	1,023.9	9.0	0.2
Subtotal men	<u>2,323.3</u>	<u>2,461.3</u>	<u>138.0</u>	<u>1.2</u>
Saudi women	103.0	120.0	17.0	3.1
Non Saudi women	44.9	44.9	—	—
Subtotal women	<u>147.9</u>	<u>164.9</u>	<u>17.0</u>	<u>2.2</u>
Subtotal: Saudis	1,411.4	1,557.4	146.0	1.9
Subtotal: Non Saudis	1,059.8	1,068.8	9.0	0.2
TOTAL	<u>2,471.2</u>	<u>1,626.2</u>	<u>155.0</u>	<u>1.2</u>

Source: Third Development Plan 1980 - 1985, p. 98

On the other hand, there will be little change in the overall participation rates of Saudi women. Following the growth in the educational system, there will be an expectation of more educated women finding opportunities in mainly urban employment. However, the numerical impact of this increase will be offset by a decrease in the number of female farm workers. This is especially the case regarding the younger age groups because of the increased schooling factor. During the Third Plan period, the average participation rate for working Saudi women will therefore remain at approximately 6 per cent of the total. The projection for labour supply and demand underlying the civilian employment is also complicated. The projected increase in the size of the civilian labour force over the Third Plan is 155,000, representing an annual growth rate of 1.2 per cent.

This increase corresponds to the difference between new civilian employment opportunities (310,000) and the estimated number of people leaving agriculture (70,000) and construction (85,000). The limitation on the growth of expatriate workers means the non-Saudi segment of the labour force will only increase by 9,000 qualified personnel. The net increase in the indigenous work force for civilian employment will be 146,000.

The changes in civilian employment during the Third Plan and a comparison of the growth rates between the Second and Third Plan are shown in tables 4.4 and 4.5. Table 4.4 also compares the percentage distribution of employment by economic activity in 1979/80 with the projections for 1984/85. Against an employment increase of 725,000 during the Second Plan, the projected net growth in the Third Plan will be only 155,000. This



Table 4.4

Changes in Civilian Employment in the Third Plan

(estimated employment in 1979/1980 and in 1984/1985 by economic activity)

Economic Activity	Employment In:		Percent Change 1979/80 - 1984/85	Percent Distribution	
	1979/80	1984/85		1979/80	1984/85
	(In Thousands)				
<u>Producing Sectors:</u>					
Agriculture	598.8	528.8	(11.7)	24.2	20.1
Other mining	7.3	9.8	34.2	0.3	0.4
Other manufacturing	104.2	164.2	57.6	4.2	6.3
Utilities	31.5	47.0	49.2	1.3	1.8
Construction	330.1	245.1	(25.7)	13.4	9.3
SUBTOTAL:	1,071.9	994.9	(7.2)	43.4	37.9
<u>Services Sectors:</u>					
Trade	310.6	339.6	9.3	12.6	12.9
Transport	214.6	274.6	28.0	8.7	10.5
Finance	34.8	44.8	28.7	1.4	1.7
Other services	482.3	505.3	4.8	19.5	19.2
Government (1)	321.0(2)	421.0(2)	31.2	13.0	16.0
SUBTOTAL:	1,363.3	1,585.3	16.3	55.2	60.3
<u>Total non oil economy</u>	2,435.2	2,580.2	6.0	98.6	98.2
<u>Oil sector</u>	36.0	46.0	27.8	1.4	1.8
<u>TOTAL</u>	2,471.2	2,626.2	6.3	100.0	100.0

(1) Excludes non civilian employment

(2) This government figure includes an estimated 49.6 thousand daily workers, not classified as civil servants.

Source: Third Development Plan 1980 - 1985, p. 100

Table 4.5  
Changes in Civilian Employment in the Second and Third Plan Periods  
 Comparison by economic activity

<u>Economic Activity</u>	<u>Employment Increase</u>		<u>Annual Growth Rate</u>	
	<u>2nd Plan</u>	<u>3rd Plan</u>	<u>2nd Plan</u>	<u>3rd Plan</u>
	<u>(Thousands)</u>		<u>(Percent)</u>	
<u>Producing Sectors</u>				
Agriculture	(96.2)	(70.0)	(2.94)	(2.46)
Other mining	3.9	2.5	16.51	6.07
Other manufacturing	29.8	60.0	6.97	9.52
Utilities	15.4	15.5	14.37	8.33
Construction	157.8	(85.0)	13.89	(5.78)
Subtotal	110.7	(77.0)	2.20	(1.48)
<u>Service Sectors</u>				
Trade	157.0	29.0	15.12	1.80
Transport	100.1	60.0	13.39	5.05
Finance	21.7	10.0	21.58	5.18
Other services	252.3	23.0	15.96	0.94
Government(1)	74.3	100.0	5.41	5.57
Subtotal	605.4	222.0	12.46	3.06
<u>Total non-oil economy</u>	716.1	145.0	7.21	1.16
<u>Oil sector</u>	8.6	10.0	5.61	5.02
<u>TOTAL</u>	724.7	155.0	7.19	1.22

(1) Excludes non civilian employment.

represents a decline in the average annual growth rate of employment from 7.2 per cent in the Second Plan to 1.2 per cent during the Third Plan. The sector which is most important, if the economic diversification policies of the Government are to be implemented, is the non-oil private sector. Employment in this sector is estimated to increase by a net total of 45,000 at a rate of 0.4 per cent annually. The scope for public sector (civilian) employment growth is estimated at 100,000 over the next five years.

The final projection concerns productivity. The Third Plan states that it is "axiomatic" for the Kingdom that its labour force, comprising over 65 per cent of the male and 5 per cent of the female population of working age, should achieve progressively higher levels of productivity. This is to be measured in terms of value-added per employee. It is the pre-condition for the non-oil economy's sustained expansion, including non-inflationary income growth from employment. On page 103, the Third Plan also states that without an increase in productivity in the five years to 1979/80, the necessary increase in employment would have been about 1.7 million, not 710,000. The Second Plan achieved this productivity gain by migration from low productivity agriculture, and from new entrants to the work force joining the high productivity sectors, especially construction.

The Third Plan is expected to see growth in sectoral productivity of between 4 and 5 per cent per year, representing a doubling of the conventional type of productivity growth relative to the Second Plan. The gains will come from the following sectors: agriculture (due to further migration); manufacturing (on account of high productivity projects

financed by SDF); energy and water (reflecting the substantial capital outlays in both areas); and transport, communications and storage (mainly resulting from large-scale capital-intensive developments). A relatively low rate of productivity increase is likely to come from construction, due to the fact that it will be the larger (foreign) firms that will withdraw from the construction market rather than the local contractors operating on a smaller sector. The expectation is that competitive pressure will mean effective utilisation of both capital and labour.<sup>5</sup>

#### 4.3 LABOUR FORCE PROBLEMS

In 1982 Shaw and Long wrote:

"The principal barrier in every sector of the Saudi economy today is the lack of available manpower".<sup>6</sup>

No confirmed figures are available for the overall population of the Kingdom both because the Saudis are sensitive about the size of their own percentage of the population, and because of the size of the foreign population. Inflated numbers of Saudis in the work force tend to be set against extremely conservative estimates of the number of foreign workers for a cosmetic effect. The magnitude of the problem is summed up by a recent American State Department estimate that 80 per cent of the non agricultural workers in Saudi Arabia are foreign.

According to the 1974 Population and Housing Census, there were slightly over 7 million people in the Kingdom at the end of 1974, including

expatriates residing in the country. The 1974 Population Census was the last official population survey to be taken. This number also includes the 1.88 million unsettled population. Table 4.7 shows there were 16 cities in 1974, each with a population of over 30,000. Riyadh, the capital of the Kingdom, is the largest city with a population in excess of 667,000. In all, the 16 major urban areas represent about 37 per cent of the total population. Since the Census, the urban population has grown very fast due to a large inflow of people from the agricultural sector as well as from outside the Kingdom. "A Guide to Industrial Investment", published in 1981, suggests that the population has increased by 1.5 million to about 8.5 million in 1980.<sup>7</sup>

However, in 1979 Birks and Sinclair carried out an extensive review of the size of the population of Saudi Arabia, considering both historical and contemporary sources. They found that even the 1974 Census contained major shortcomings. A series of estimates, approximations and calculations were used in order to produce 'an acceptable figure of population'. Table 4.6 summarises these estimates. The total population of Saudi Arabia in 1974/75

Table 4.6

SAUDI ARABIA: Estimate of Population and Employment in 1974/75

	Population	%	Employment	%
Saudi Arabian Nationals	4,592,540	74.6	1,026,400	57.0
Non nationals	1,562,400	25.4	773,400	43.0
<hr/>				
TOTAL	6,154,940	100.0	1,799,800	100.0

Source: Birks, J.S. and Sinclair, C.A. The International Migration Project

University of Durham, 1979, p. 33

was estimated by Birks and Sinclair at 6.1 million people. 4.59 million of whom are Saudi Arabian nationals and 1.56 of whom are non nationals. The workforce was estimated at 1.8 million of whom 1.03 million are nationals and 773,400 are migrants.<sup>8</sup>

There is therefore, some debate regarding the actual number involved in the Saudi population and workforce. There is, however, general agreement that the Saudi labour market is a two tier market. On one level is the modern sector from which the development effort must draw its managers and technicians. On another level is the traditional labour market with limited skills, limited literacy and an anti-development bias.<sup>9</sup> While the modern sector has forged ahead and is associated with the development of private urban centres, the rural agricultural sector has remained relatively traditional and subsistence based. There are only a few areas which have been transformed by large scale agricultural projects. The two separate labour markets have meant that a large proportion of the Saudi Arabian national workforce has not participated in the development of its own country.

The reasons which account for so many Saudi Arabian nationals remaining outside the modern sector are complex. Until the implementation of the Second Development Plan and the investment in infrastructure, the sheer distances and poor communications between regions was a significant factor. Also, not until the great increase in oil revenues in the 1970's did the pressures and opportunities exist for Saudis to join the modern sector. Paradoxically, Government loans and grants to small farmers have had an enervating effect on some - actually preserving the subsistence

Table 4.7

Cities with Populations of 30,000 and over in 1974  
(thousand)

<u>City</u>	<u>Number of Households</u>	<u>Population</u>
Riyadh	102	667
Jeddah	97	561
Makkah	68	367
Taif	31	205
Medina	35	198
Dammam	22	128
Hofuf	15	101
Tabuk	11	75
Buraida	9	70
Mobarraz	8	54
Khamis Mushait	8	50
Al-Khobar	9	49
Najran	9	48
Hail	6	41
Jizan	6	33
Abha	5	30
TOTAL	441	2,677

Note: Figures rounded to nearest thousand

based rural sector. Another fact is the high value Saudis place on leisure and perhaps, a disinclination to work. The availability of so-called, unearned incomes, like payments resulting from patronage and rents, have not helped.

There are other reasons. It does seem likely, however, that Saudis in the traditional sector will be drawn into the modern sector by virtue of the continuing expansion of the economic system. This will be a gradual process and in the meantime, non nationals cause concern. The increasing efforts of the Government in the field of human resource development have yet to come to terms with the motives and aspirations of Saudi Arabian individuals and how to change them in the short term. There is a suggestion that the Government might be more successful if the general level of wealth was reduced.<sup>10</sup> However, although some might be stimulated into action, others might feel extremely dissatisfied, and the overall effect might well be negative.

It seems, at least for the present, that the Kingdom betrays symptoms of conflicting objectives. Migrant workers are still a necessity if development is to continue at the same rate. Perhaps the decline in the rate of increase of foreign workers demanded by the Third Plan is too ambitious. Table 4.8 shows the breakdown of the different nationalities working in Saudi Arabia. The Government is concerned that the immigrant communities will increase and even outnumber the Saudis. There is not only concern for the number of Indians and Pakistanis. Despite a suggest Arab 'solidarity', Saudis appear detached from Palestinians, have little respect for Yemenis and mistrust Egyptians. They feel that such workers are

Table 4.8

Foreign Residents in Saudi Arabia in 1982

Yemenis	600,000
Egyptians	300,000
Palestinians and Jordanians	100,000
Sudanese	50,000
Lebanese	15,000
Syrians	40,000
Other Arabs	10,000
Koreans	100,000
Thais	50,000
Filipinos	200,000
Chinese	7,000
Indonesians and Malays	15,000
Indians	75,000
Pakistanis	300,000
Bangladeshis	15,000
Sri Lankans	5,000
Turks	40,000
Afghans	20,000
Somalis	50,000
Other Muslims	5,000
Japanese	5,000
American	40,000
German	10,000
French	15,000
Italian	13,000
Swedes	3,000
Greeks	10,000
Other Europeans (includes Canadians and Australians)	10,000
TOTAL:	<u>2,103,000</u>

Source: Shaw, J.A. and Long, D.E., Saudi Arabian Modernisation  
The Impact of Change on Stability. Praeger, 1982, p. 47

benefitting inordinately from Saudi Arabian development. At the same time, there is an under-current of a return to strict Islamic principles. Some aspects of economic development and modernity appear to be unacceptable to religious leaders.

The consequence of these conflicting forces, the one to modernise with foreign assistance, the other to retain a distinctly Saudi Arabian and religious society, results in paradoxical and sometimes, apparently unstable situation. For example, Saudi Arabia wishes to see more local nationals employed in services, but it prohibits the employment of females in most government offices. These tensions may be ignored by entrepreneurs and others managing development, but eventually they will have to be faced.<sup>11</sup> Perhaps this is the reason for the attempt by the Third Development Plan to restrict the growth of expatriate workers in the country. Some would say that the Third Plan has tried to change the situation too quickly. However, it may be that the Government is aiming to mark time, while it develops its own indigenous human capital. It may also be that the Saudi Government recognises it has aimed high, perhaps too high, which may be reflected in the following statement of the Third Plan:

"There will be continuous review of the whole subject of manpower and employment in case it proves necessary to re-evaluate the policies".<sup>12</sup>

#### 4.4 ROLE OF EXPATRIATE LABOUR IN IMPORT SUBSTITUTION

Expatriates have played a major role in the economic development of Saudi Arabia. All development plans to date have demanded rapid development and Saudi manpower has been, and still is, insufficient to meet these needs. However, in this section there is an attempt to find out more about the actual part played by expatriates. Table 4.9 looks at the calibre of the entire work force in Saudi Arabia, both Saudi and non Saudi. It also looks at the probable changes which have taken place between 1975 and 1980. The table shows the comparatively high number of non Saudi managers and officials in 1980. It also shows that there are a high number of Saudis who are trained professionals. In 1980 there were 52,900 Saudi professionals in the work force, compared with 23,500 non Saudis. Another interesting feature of table 4.9 is the service sector. In 1975 there were 105,200 Saudis working in the service sector, more than double the number of non Saudis. By 1980 the situation had changed so that there are more non Saudis working in services. The 1975 situation reflects the Saudi contentment to work in occupations like providing a taxi service. The 1980 figure reflects the need for expatriates to maintain projects already completed. Finally, it is worth noting that there are no expatriates working in Saudi Arabia who might be described as unskilled. There is, of course, an abundant supply of unskilled labour of Saudi nationality.

Having looked at the calibre of non Saudis working in Saudi Arabia, the next question is the kind of firm these non Saudis work in. Do non Saudis work predominantly in large firms? Or, is it more a question of the majority working in a particular economic sector? Table 4.10 gives details

Table 4.9

Estimated Manpower Distribution in Various Occupational Groups  
(thousands)

Occupational groups	1975	1975	1980	1980
	Saudi	Non-Saudi	Saudi	Non-Saudi
Managers and officials	7.4	6.3	8.7	12.4
Professionals	48.4	15.7	52.9	23.5
Technicians and sub-professionals	25.0	31.4	33.4	81.3
Clerical	67.5	31.4	99.6	121.8
Sales	82.3	47.1	97.2	112.6
Service	105.2	47.1	134.5	145.2
Operatives	40.0	25.1	57.1	51.4
Skilled workers	70.1	47.1	93.5	101.9
Semi-skilled	170.0	62.8	265.0	162.5
Subtotal	615.9	314.0	841.9	812.6
Unskilled	244.0	—	296.4	—
Farmers	311.2	—	281.0	—
Bedouin	114.9	—	98.7	—
Subtotal	670.1	—	1,518.0	—
GRAND TOTAL	1,286.0	314.0	2,359.9	812.6

Source: El Mallakh, R. Saudi Arabia: Rush to Development, 1982, p. 418

Table 4.10

Number of Establishments by Employment Size and Economic Activity in 1981

Number of Establishments by Employment Size	1	2-4	5-9	10-19	20-49	50-99	100+	Total	% of total employing 50+ in each sector
Food, Beverages and Tobacco	445	1,121	339	149	69	22	26	2,171	2.2
Textiles, clothing and leather	2,142	4,846	923	93	12	3	2	8,021	0.06
Wood, Wood Products and furniture	372	831	507	214	48	9	4	1,985	0.65
Paper Products and Printing	143	174	116	100	47	13	15	608	4.6
Chemical, Petroleum Plastic Products	26	28	32	33	43	15	18	195	16.9
Bricks, Blocks, Cement and Glass	146	942	817	371	130	47	47	2,500	3.76
Basic Metal Industries	19	25	46	19	12	2	4	197	3.04
Fab. Metal Products and Machinery	1,476	3,078	1,205	491	200	69	60	6,579	1.96
Other manufacturing Industries	172	121	9	7	5	2	1	317	0.95
TOTAL MANUFACTURING	4,941	11,236	3,994	1,477	566	182	177	22,573	0.78

Source: Kingdom of Saudi Arabia, Census of Private Establishments, 1981, Table 4, Percentages calculated by author.

of the size of firms in Saudi Arabia in 1981. As might be expected, the vast majority of firms employ 1 to 10 workers. When one looks at the larger firms by sector, it is interesting to note that nearly 17 per cent of firms in the chemical, petroleum, plastic products sector employ 50+ workers. This is easily the highest percentage. The bricks, blocks, cement and glass sector has 3.76 per cent of firms employing 50+ and, the basic metals industries 3.04 per cent. However, these percentages include Saudis and non Saudis employed by firms. The next question must be, what is the percentage of non Saudis working in each sector. Table 4.11 provides information on this question.

From table 4.11, it can be calculated that the average percentage of non Saudi workers of the total workers in each sector is 89 per cent. The lowest per cent being 82.0 per cent in other manufacturing industries and the highest, 92.5 per cent in food, beverages and tobacco. In general, there are no great differences in the distribution of Saudi and non Saudi workers in each sector. With table 4.10 in mind, there are some indications, therefore, that many non Saudis are working in large firms in the sectors of bricks, blocks, cement and glass; basic metal industries; and, chemical, petroleum and plastic products in particular. However, definite conclusions cannot be drawn from these results.

The last column of table 4.11 looks at the percentage of non Saudis in each sector as a percentage of the total number of non Saudis in manufacturing. It shows that only 5.0 per cent of non Saudi workers work in the chemical, petroleum and plastic products sector. Thus, although it may still be said that many non Saudi workers in this sector work in large

Table 4.11

Number of Establishments and Employment by Type and Economic Activity in 1981

	Type of Employees		Total	Percentage of non Saudis of total workers to each sector	Percentage of non Saudis of total non saudis in manufacturing
	Non-Saudi	Saudi			
Food, Beverages and Tobacco	15,311	1,244	16,555	92.5	10.8
Textiles, clothing and Leather	20,411	2,061	22,472	90.8	14.4
Wood, wood products and furniture	10,113	1,211	11,324	89.3	7.1
Paper products, and printing	6,957	987	7,944	87.6	4.9
Chemical, Petroleum, Plastic Products	7,128	1,068	8,196	87.0	5.0
Bricks, Blocks, Cement and Glass	32,063	2,365	34,428	93.1	22.6
Basic Metal Industries	2,338	117	2,455	95.2	1.6
Fab. Metal Products and Machinery	46,718	4,820	51,538	90.6	32.9
Other manufacturing industries	963	212	1,175	82.0	0.7
TOTAL MANUFACTURING	142,002	14,085	156,087	91.0	

Source: Kingdom of Saudi Arabia, Census of Private Establishments, 1981, Table 1. Percentages calculated by author

firms, those employed in this sector do not account for many of the non Saudis working in Saudi Arabia in 1981. This also applies to basic metal industries which accounts for only 1.6 per cent of non Saudi workers. Table 4.11 shows that the majority of non Saudi workers are employed in the more construction-orientated industries of bricks, blocks, cement and glass and fabricated metal products and machinery. Regarding the former sector, table 4.10 and 4.11 together show that although only a small number of firms employ 50+ workers, this sector employs a large percentage of non Saudi workers in Saudi Arabia.

Together these two tables provide a fair indication of what the situation was at the end of the Second Development Plan. The next question must be what changes can be expected in the future? In earlier chapters, it has been made clear that many of the major infrastructural projects have now been completed or, are nearing completion. By 1985 a much smaller percentage of non Saudi workers can be expected to be accounted for in the construction-orientated industries. Also, as the larger foreign construction companies withdraw, the smaller, Saudi (construction) firms will become more important. However, there are no major reasons to suggest that the sector of chemical, petroleum and plastic products will not retain its primary position regarding numbers of large firms. Although much capital is employed in this sector, the scale of activities such as petroleum, mean large numbers are employed.

#### 4.5 THE REGIONAL EMPLOYMENT STRATEGY UNDER THE THIRD PLAN

The Third Development Plan introduces a more explicit and co-ordinated approach for dealing with the regional dimensions of national planning. It

states:

"In the most general terms, regional planning aims at providing a spatial counterpart to the objectives pursued at the national level, and acts as a means for co-ordinating the regional activities of development agencies."<sup>13</sup>

The Government has tried to put this strategy into practice in recent years by setting up development agencies with a regional responsibility. There has been an attempt to apply national objectives in both rural and urban environments. The long term aim is to achieve an even geographical distribution of material and social progress. The idea is to develop productive activities in all regions to enable them to retain as many of their inhabitants as possible. Also, to extend the distribution of services to assist those communities with the potential for self sufficiency, in accordance with the principles of Islam. The government is trying hard for many Saudis all over the Kingdom to benefit from the oil revenue. Regional strategy, like others, is essential to political stability.

However, one of the indirect results of regional policy, can be a slower national growth of industry which may reduce the demand for Saudi labour. This would, therefore, be counter-productive. On the other hand, it may reduce urban labour supply by keeping workers in the countryside, as already mentioned. Like developed countries, Saudi Arabia has the problem of what principle to follow in its regional policy. Should it be trying to bring jobs to workers or, workers to jobs? There are advantages in using

either principle. A major problem of bringing workers to jobs, that is, the urban areas, is one of regional imbalance.

Briefly, Saudi Arabia's regional strategy has three key elements. 1) The co-ordination of activities, projects and programmes of ministries and the other development agencies having regional or district responsibility. 2) The more equitable distribution of socio-economic activities, and 3) The provision of a development framework for the design and implementation policies and programmes in all regions, especially rural areas. Such a framework will pay critical attention to the availability of resources, manpower and water in particular. In the future the aim is to introduce national, regional and district centres spread fairly evenly throughout the Kingdom.<sup>14</sup>

Table 4.12 looks at the changes which have taken place in the size of firms between 1976 and 1981, by region. The table shows that the total number of firms in the Kingdom more than doubled from the beginning of the Second Plan to that of the Third Development Plan. It is also interesting to note that the absolute total of establishments for each region, has doubled in those five years, with the exception of the Western region. However, it must be said that in 1976, as well as 1981, the Western region had by far the highest number of establishments. In 1976, whereas the Western region had 31, 976 establishments, the Northern region had only 3,701. Table 4.12 also shows that there are still many more establishments in the Central, Western and Eastern regions, than Northern and Southern. At the same time, table 4.14, which summarises certain aspects of table 4.12 and 4.13, appears to show that the stated regional strategy of the

Table 4.12

## Comparison of Establishments by Region and Employment Size in 1976 and 1981

REGION AND YEAR	TOTAL	NUMBER OF ESTABLISHMENTS BY EMPLOYMENT SIZE						
		1	2-4	5-9	10-19	20-49	50-99	100+
CENTRAL								
1976	22,640	12,540	7,189	1,714	605	333	114	145
1981	42,875	18,111	16,730	4,433	2,000	923	305	373
WESTERN								
1976	31,976	18,047	10,816	1,861	640	387	114	111
1981	58,640	25,841	23,493	5,547	2,153	932	329	345
EASTERN								
1976	12,994	7,177	4,049	899	408	282	65	114
1981	25,196	10,620	9,034	2,658	1,328	742	401	413
NORTHERN								
1976	3,701	2,296	1,144	150	57	31	9	14
1981	10,095	5,237	3,840	652	241	78	31	16
SOUTHERN								
1976	5,993	4,068	1,561	222	67	41	17	17
1981	14,052	7,489	5,218	965	263	72	27	18
TOTAL								
1976	77,304	44,128	24,759	4,846	1,777	1,074	319	401
1981	150,858	67,298	58,135	14,255	5,985	2,747	1,093	1,165

Source: Kingdom of Saudi Arabia, Census of Private Establishments 1981, Table 3.

Table 4.13

## Comparison of Number of Establishments and Total Employment for the Same Cities in 1976 and 1981 Censuses

	NUMBER OF ESTABLISHMENTS		NUMBER OF EMPLOYEES	
	1976	1981	1976	1981
CENTRAL REGION				
TOTAL	22,640	41,329	111,934	305,827
Riyadh	16,409	30,611	94,991	272,376
Buraidah	2,005	3,281	5,392	11,200
WESTERN REGION				
TOTAL	32,015	57,822	114,302	326,735
Makkah	8,114	12,332	22,657	43,632
Jiddah	13,828	28,651	62,907	221,975
Taif	4,805	6,735	11,902	22,005
EASTERN REGION				
TOTAL	12,994	24,164	92,437	302,533
Al-Dammam	6,003	10,274	17,095	151,671
Al-Khubar				
Al-Hufaf	2,630	3,878	6,593	10,652
NORTHERN REGION				
TOTAL	3,662	8,936	12,893	26,336
Hail	1,198	2,721	2,332	8,968
Tabuk	1,015	2,719	6,336	8,299
SOUTHERN REGION				
TOTAL	5,993	12,815	16,622	33,700
Khamis Mushait	1,489	3,002	4,860	8,608
KINGDOM TOTAL				
	77,304	144,436	348,188	995,131

Source: Kingdom of Saudi Arabia, Census of Private Establishments 1981. Table 9.

Table 4.14

Percentage changes between 1976 and 1981 by region

(based on 4.10 and 4.11)

REGION	Percentage increase in firms employing 50+ by region in 1976/1981	Percentage increase in total number of firms in each region 1976/1981	Percentage increase in total number employed in each region in 1976/1981
CENTRAL	261.78	189.38	273.22
WESTERN	299.56	183.39	285.85
EASTERN	454.75	193.90	1071.16
NORTHERN	204.07	272.76	204.27
SOUTHERN	132.35	234.47	202.74
TOTAL OF REGIONS	313.61	195.15	285.80

Percentages calculated by author.

Third Plan has succeeded to some extent. The Northern and Southern regions appear to have a higher rate of increase in terms of number of establishments.

Column 2 of table 4.14 shows that there have been some very large percentage increases in the number of firms in the Northern and Southern regions. This at least shows greater commercial activity in these regions. When one looks at the size of the firms, table 4.12 shows comparatively few firms employing 50+ workers. However, when table 4.14 looks at the percentage increases in firms employing 50+ workers between 1976 and 1981, this time the situation looks less promising. Both Northern and Southern regions are well below the percentage increases of the other three regions. Eastern region has a notably high increase, 454.75 per cent in firms employing 50+ workers. This is discouraging because of the low base that the Northern and Southern regions start from. One of the reasons for this is the very large scale activities taking place in cities like Jubail, Dammam, al-Khubar and Dhahran. For example, the iron and steel joint venture with Korf involves construction of an integral steel complex at Jubail.<sup>15</sup> It appears that although Northern and Southern regions are attracting new establishments, they are not attracting the larger firms. This means that these regions are not able to employ anything like as many as the other three regions, the Western, Central and Eastern regions. Inhabitants of Northern and Southern regions might be encouraged to move to a different region to seek employment. If this happens to any great extent, the character of the regions and Saudi Arabia will change which is not in line with Government policy.

Table 4.13 shows the significant difference in numbers employed in each region. The largest number of employees in 1981 is the Western region with 326,735 and the smallest in Northern region with 26,336. Table 4.14 looks again at the changes in employees between 1976 and 1981. When column 3 is observed, it may be concluded that attempts at regional balance have not succeeded. Not only was the situation much worse in terms of number of employees in the Northern and Southern regions, but it is not getting better. The situation has become more acute. There was an increase of just over 200 per cent for Northern and Southern regions compared with 273 per cent, 285 per cent and 1071 per cent for Central, Western and Eastern regions, respectively. The 1071 per cent increase for Eastern region is in line with the 454 per cent increase in firms employing 50+ workers shown in column 1. As was pointed out above, this is a direct result of new large scale enterprises, particularly around Dammam. At least, the regional changes which have taken place under the Second Plan, have not meant an overall centralisation around the capital and in the Central Region, as might have happened. Even before the growth of Riyadh made itself felt, there was already a number of market towns spread over Central Arabia.<sup>16</sup> This 'natural' trend could have continued, which could suggest some success by the Government. However, it is difficult to evaluate this analytically.

When this regional imbalance is looked at regarding import substitution policies, the current situation does not look promising. After all, a domestic market is essential to the success of import substitution policies. Where there is purchasing power, domestically produced goods can be bought - the larger the number of establishments and

employees, the larger the domestic market. Additionally, the lagged effect of the multiplier is also important as more products and services are produced in response to the needs of already existing firms. If the Third Plan continues to produce the poor results of the Second Plan regarding regional balance, the Northern and Southern regions will hardly participate in the development of Saudi Arabia. Unfortunately, the geographic features of these regions has a negative effect on their involvement in development.

The reasons surrounding the existence of the two tier labour market have already been discussed. Many Saudis do not participate in the modern sector, but it is as potentially dangerous, if regions do not receive the benefit of the oil revenue. Some inhabitants of the Northern and Southern regions will undoubtedly move to other regions and so benefit. However, this will not alleviate the problem of those remaining in the Northern and Southern region. Those remaining may well be unskilled and working in the traditional sector and most vulnerable to political provocateurs. The Government accepts that it can encourage the people to move but not to force them. It is hoped and is possible that gradually the less economically attractive settlements will become de-populated through young people leaving them.<sup>17</sup>

#### 4.6 MANPOWER AND EMPLOYMENT IN SELECTED CITIES

A major aspect of development in Saudi Arabia is the fact that development has taken place around particular areas. Industrialisation is concentrated in the major cities and outside the Jeddah, Riyadh and Dammam/Al Khobar areas, there is surprisingly little development. Table

4.13 looks at the changes taking place in selected cities. Some significant facts emerge. The city of Riyadh, Central Region accounted for 20 per cent of establishments in 1976 and 27 per cent of employment. In 1981 it accounted for 21 per cent of establishments, but the situation was unchanged regarding employees. There was more change in Jeddah. In 1976 it accounted for 19 per cent of establishments and 22 per cent of employees and five years later it accounted for 18 per cent for both categories. The Eastern region did not show a more marked change either. In 1976 the Damman area, including the municipalities from Rahima to Al Thuqbah, contained 10 per cent of establishments and 24 per cent of employment. Five years later, the Damman area accounted for 11 per cent of establishments and 21 per cent of employment.<sup>18</sup>

Table 4.15 looks at manufacturing in the three above mentioned cities. The table looks at the number of establishments and total employment by economic activities for Jeddah, Riyadh and Damman. The total manufacturing figures portray a similar situation to that seen in the regions as a whole. Compared to Jeddah and Riyadh, Damman has a large number of bigger firms. The firms of Damman employ an average of 20 employees, while those of Jeddah employ 9 and Riyadh 8. The oil-related industries of Damman are more capital intensive, large scale undertakings. As earlier chapters have suggested, the firms in the category of chemical, petroleum and plastic products in Damman are particularly large scale.

Also, the table shows that the firms in Jeddah in the food, beverages and tobacco sector account for the employment of more than 5,000, a comparatively high number. This can probably be explained by the large

Table 4.15

Number of Establishments and Total Employment by Economic Activity  
for Selected Cities, 1981

CITY	JEDDAH		RIYADH		DAMMAM	
	Number of Establishments	Total Employment	Number of Establishments	Total Employment	Number of Establishments	Total Employment
Food, Beverages and Tobacco	267	5,072	462	3,535	58	1,281
Textiles, Clothing and Leather	1,299	3,476	1,860	6,216	321	907
Wood, Wood Products and Furniture	344	2,455	365	2,656	92	772
Paper Products and Printing	164	2,852	157	1,677	56	1,764
Chemical, Petroleum Plastic Products	54	2,094	61	2,002	31	2,427
Bricks, Blocks, Cement and Glass	387	7,519	451	10,519	95	5,680
Basic Metal Industries	85	771	24	244	3	626
Fab. Metal Products and Machinery	1,121	11,200	1,591	13,723	331	6,993
Other Manufacturing Industries	99	323	24	116	15	359
TOTAL MANUFACTURING	3,820	35,762	4,995	40,688	1,002	20,809

Source: Kingdom of Saudi Arabia, Census of Private Establishments 1981, Table 3.

number of wadis in the Western region. The area is relatively fertile so the manufacture of foodstuffs can be described as vertical integration and a natural progression. Additionally, the Jeddah area is the largest single market in the Kingdom for foodstuffs and the main entry port for food imports. Riyadh, on the other hand, accounts for a relatively high number of employers in the sector of textiles, clothing and leather. An obvious explanation could lie in the fact that Riyadh is the capital city and like other capitals, it is the fashion leader. This is not so. In fact, there is very little fashion in Saudi Arabia as a whole. It could be that the more cosmopolitan city of Jeddah creates a demand, as it is well connected by road to Riyadh. Thus cloth is imported through the Eastern ports such as Damman, which is well connected by rail and road to Riyadh, where it is manufactured into clothing. From Riyadh a national distribution is easier for consumer goods, than from Jeddah or Damman.

Damman already provides plenty of employment opportunities which may be one reason Riyadh was selected as the administrative centre for the country. This would fall in line with training manpower in all regions. Planners see human resources as the country's most scarce and lasting resource, a resource which is critical to Saudi Arabia's future.<sup>19</sup> All three cities, Jeddah, Riyadh and Damman show a large number of people employed in construction based industries. The firms in Damman appear to be larger scale. Earlier data in this chapter showed that the larger construction firms had foreign participation. Further, it was suggested that these larger firms would withdraw from Saudi Arabia in the future, so most of the large scale projects of the Second Plan have now been implemented. Even when this fact is considered, Damman, like the whole of

the Eastern region, is expected to grow in the future. Although the industrialisation plans of the Third Plan appear to make this a virtual certainty, the dramatically reduced oil revenues of the 1980's must cast some doubt on the subject.

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CHAPTER 5EXPORT DIVERIFICATION PLANS5.1 POLICIES FOR EXPORT DIVERSIFICATION

"Diversification of the economy is one of the fundamental long term goals of development, and the strategy for the Third Plan is to accelerate the process of diversification."<sup>1</sup>

The objective for economic development is to give priority to investment in the producing sectors of agriculture, industry and mining. The aim is for this development to be undertaken by the private sector. The government's role is to support and stimulate the private sector in its tasks and encourage joint ventures with foreign companies. Clearly, if exports are to be diversified away from oil, the domestic economy must first become diversified.<sup>2</sup> In chapter 3, import substitution policies were highlighted; they can only go so far in Saudi Arabia because the domestic market is so small. Export diversification is essential if scale economies are sought. Still, the government has no alternative other than to accept that in the short term crude oil exports will maintain their central importance domestically, as well as internationally. Domestically, they will continue to provide financial cover for the Kingdom's expenditure budgeted for the period, to pay for imports and other payments abroad, and, continue to strengthen the Kingdom's international financial reserves. Internationally, crude oil and other hydrocarbon exports will maintain their stabilising role in the world economy and supply energy.

It is interesting to note here, that the daily level of crude oil exports which would pay for the Government's aggregate expenditures on economic development during the Third Plan is slightly under 5.3 million barrels a day, according to the Third Plan. However, at the OPEC meeting in Vienna in September 1983 Saudi Arabia's quota was agreed at 5.0 million barrels of the 17.5 million barrels a day total OPEC production. This suggests that oil revenues are not reaching their desired level, but this may not be the case. The Financial Times reported in mid October 1983 that OPEC was producing 18.5 million barrels a day with Saudi Arabia actually producing 5.5. Although such "facts" are as yet unconfirmed, they do highlight the need for diversification of the Saudi economy in the long term.

In the Third Plan, it is stated that the private sector will be stimulated by providing information and research on investment opportunities for its citizens, by conducting more economic feasibility studies, and by giving support to applied research projects. Many financial incentives are offered and in particular, encouragement is given to the establishment of joint venture companies with foreign as well as Saudi partners, to undertake large scale projects. Completion of infrastructure projects is also seen as essential. Under the Third Plan, some kinds of investment are given a higher priority than others. Regarding import substitution policies, large-scale mechanized agricultural projects should be encouraged. With export diversification policies in mind, projects which maximize the value-added from crude oil production through developing hydrocarbon based industries are important. Overall, projects which introduce new technologies are also given priority.

For the most part, development of the non oil sector is undertaken by the Saudi private sector, usually with the objective of import substitution. Alternatively, much of the development of the oil sector is expected to be, and is undertaken as joint ventures with foreign companies with the aim of diversifying exports. Table 5.1 indicates the expected relative weights of the oil and non-oil sectors in the Kingdom's total gross domestic product (GDP), expressed as a percentage of the non-oil economy.

Table 5.1: Relative Contributions to GDP of the Oil and Non-Oil Sectors<sup>a</sup>

	<u>1979/1980</u>	<u>1984/1985</u>
<u>Non-Oil Sectors</u>	100.00	100.00
<u>Oil Sector</u>		
(crude and refined products)	164.76	130.41
	-----	-----
TOTAL	264.76	230.41
	-----	-----

a In % of the non oil economy, calculated at average international prices for oil products in 1979/1980, taking also into account prevailing domestic prices where necessary.

Source: The Third Development Plan 1980 - 1985 p. 89.

The projections for growth in the Third Plan have been estimated in consideration of the effects of the new manpower policy on the size of the labour force, as discussed in chapter 4. The growth rate for the non oil economy between 1980 and 1985 is expected to decrease from the Second Plan's average rate of 15 per cent to 6.2 per cent per year. Given the Kingdom's plans for export diversification, it is therefore a little surprising to find the marked decrease in the relative contribution of the oil sector. As will be seen, although the export of refined oil products increases, the export of crude oil decreases. On the other hand, the increase in the non oil sector is expected to be achieved by the doubling in the average growth rate of sectoral productivity as a result of lower unit costs or higher value products, or both.<sup>3</sup>

In short, in the Third Plan increased emphasis is placed on expanding the contributions made to national wealth by agriculture, minerals, hydrocarbons (particularly natural gas) and the manufacturing industry. The primary objective for industrialisation is the eventual establishment of a production base that will reduce the country's heavy dependence on oil as the main source of income. Looney makes two points on the above strategy. Firstly, industrialisation does not inevitably lead to sustainable, long term growth. In Iran the process was largely initiated by expatriate companies and individuals with no permanent commitment to the welfare of the country. Industry is of no use if it forms a symbolically modern sector of the economy without developing ever expanding linkages with the indigenous economy and culture. Secondly, development economists often prize industrialisation for its employment-generating effects. This should not be a priority for Saudi Arabia, given its small population.

Non oil related jobs will obviously be needed. In the short run though, there may be no point in creating jobs that can only be filled by foreigners.<sup>4</sup>

The obvious reason for export diversification policies is to reduce the country's dependence on primary exports. The Government wishes to establish a complex of export-oriented heavy industries in collaboration with foreign and domestic enterprise, with a view to exploiting the country's potential comparative advantage where possible. At the same time it wishes to provide incentives and external economies to the private sector to establish a number of industries supplying the basic consumer and development needs of the economy, thus reducing the country's dependence on imports. The general need to increase the economy's capacity to competitively produce products for the domestic and export market is also recognised. The exploitation of the substantial comparative advantages arising from low-cost energy must be an aim. Objectives also include the desire to extend the Kingdom's access to modern technology, and develop a regionally balanced industrial sector with optionally sized plants in all sectors. Further, the government aims to promote interlinkage among industries while reducing dependency on expatriate skills by national skill creation.

Given the long term export diversification policies, the future for the private sector is bright. However, he suggests that certain obstacles to change exist. There is a need for reliable statistics on current output, investment, employment and industrial capacity. The new census of

manufactures are kept confidential. Government machinery needs to be strengthened. Rules governing incentives change too rapidly for businessmen to exploit them. Further, administrators are not familiar with the problems of industry and their planning activity is too centralised on Riyadh. Finally, the limited size of the market makes it difficult to foresee the successful implementation of import substitution projects. Some, like construction projects are already in a supply-demand equilibrium. In 1982 some opportunities still exist in foodstuffs, plastics, chemicals and metal working, However, increasing attention must be focussed on export opportunities from the large petrochemical plants planned for Yanbo and Jubail.<sup>5</sup> It is in this field that the developed world market can be exploited and where economic rationale suggest there is promise.

The Heckscher-Ohlin theory of international trade suggests a country tends to have lower comparative costs in the commodity that uses the largest amount of the relatively cheapest factor in its economy. The theory indicates that Saudi Arabia should establish and promote industries that are most likely to be efficient. Fortunately for the Saudis, these industries are not only energy intensive but also capital intensive. They utilise its abundant financial surplus as well as gas and oil. The existence of under exploited gas reserves in the Kingdom presents a strong argument for developing gas based heavy industries. Gas, especially the dry gases like methane and ethane, is an expensive product to transport. It is therefore sensible to look for more productive uses for its exploitation. Once gas has been used optionally within the domestic

economy, there is a good theoretical argument for developing gas intensive industries around it.

Such industries can be chemical industries which use the gas as a feedstock for conversion into higher value and more easily transportable chemical products. Alternatively, they can be energy intensive industries such as steel or aluminium production which can use the gas as a reasonably cheap source of energy. Of course, Saudi Arabia had virtually no heavy industry or industrial experience in the early 1970's. The Heckscher-Ohlin pattern of trade had not been established, oil exports representing a "vent for a surplus." Also, the price system had not fully developed and so was incapable of providing the planners with any correct signals about the best areas of investment. In any case, the country faced a number of other difficulties which did not help in the process of identifying effective methods of allocating the country's resources. Physical bottlenecks, manpower shortages and inflation impeded the absorptive capacity of the economy and prevented the successful implementation of diversification policies.

A number of potentially profitable projects have been identified by the Government for its investment programme. Industries have been selected that fit into the present structure of the economy and conform to the Heckscher-Ohlin theory of trade by using relatively large amounts of the Kingdom's relatively abundant factors of production<sup>6</sup> - oil, natural gas and capital. They form the next logical phase in development by providing competitive exports with the aim of paying for future imports. The capital costs of these industries are immense, so that the private sector simply

cannot attempt such investment. As a result, the Saudi Basic Industries Corporation (SABIC) was founded by the Government to initiate development of the Kingdom's heavy industries in 1976. Table 5.2 outlines SABIC's basic projects currently, under implementation, as outlined in the SAMA 1981 Annual Report.

SABIC had an initial capacity of SR 10 billion to establish these hydrocarbon-based industries and the government designated two industrial sites at Jubail on the Arabian Gulf and at Yenbo on the Red Sea for these projects. The programme includes four petrochemical complexes at Jubail and one complex at Yenbo, each complex producing 500,000 tons of ethylene annually. Other planned projects are four fertilizer plants producing ammonia and urea, two methanol plants, an animal feed plant and a steel rolling mill at Jubail. There are four ethylene complexes at Jubail which have been completed and are scheduled to start operations by the end of 1984. Total investment in these four complexes is estimated to be \$4,600 million.

Studies are being prepared for the establishment of two fertilizer plants, each having an annual capacity of 330,000 tons of ammonia. Total cost of the two plants is estimated to be \$600 million. Other projects include two methanol plants to be constructed by SABIC. Each will have an annual capacity of 660,000 tons and will cost a total of \$500 million. The steel plant at Jubail is planned to have an initial annual capacity of 800,000 tons, as table 5.2 shows. Jubail is also to be the location of a 200,000 tons per year plant, at a cost of \$1,100 million.

Table 5.2

SABIC'S Basic Project Under Implementation

Projects	Location and date of agreement	Feedstock	Annual Capacity (metric tons)	Products
<u>Metallurgical</u>				
1 - Saudi Iron & Steel Co	Jubayl (March 1979)	Iron Ore & Natural Gas	800,000	Steel Rods & Bars
2 - Jiddah Steel Rolling Mill	Jiddah (May 1979)	Steel Billets	140,000	Steel Rods & Bars
<u>Fertilizer</u>				
3 - Al-Jubayl Fertilizer Co	Jubayl (Dec. 1979)	Methane	500,000	Urea
<u>Petrochemical</u>				
4 - Saudi Methanol Co	Jubayl (Nov. 1979)	Methane	600,000	Methanol
5 - Saudi Yanbu Petrochemical	Yanbu (April 1980)	Ethane	450,000	Ethylene
			200,000	Ethylene Glycol
			200,000	L.D. Polythylene
			90,000	H.D. Polythylene
			260,000	L.D. Polythylene
6 - Al-Jubayl Petrochemical Co	Jubayl (April 1980)	Ethylene	656,000	Ethylene
			456,000	Ethylene Dycloride
			295,000	Styrene
			281,000	Ethanol
7 - Saudi Petrochemical Co	Jubayl (Sept. 1980)	Ethane	377,000	Caustic Soda
			650,000	Methanol
8 - National Methanol Co	Jubayl (Feb. 1981)	Methane	500,000	Ethylen
9 - Arabian Petrochemical Co	Jubayl (May 1981)	Ethane	180,000	L. & H.D. Polythylene
			130,000	L.D. Polythylene
			300,000	Ethylene Glycol
10 - Eastern Petrochemical Co	Jubayl (May 1981)	Ethylen		

Source: SABIC

Source: SAMA, Annual Report 1981, p. 77

The availability of gas is not the only reason for making investment in the petrochemical industry attractive. It is also both capital intensive and economies of scale are available. The industry has one of the highest capital and labour ratios in the world; investment per new job created is estimated at \$20,000 to \$100,000! Also, large-scale capacity units cost proportionately less than small or medium-capacity units to build and manpower overheads appear to have proportionately lower expenditures with large plant size. In conclusion, Saudi Arabia's abundant endowments of both raw materials and capital make the petrochemical industry appear the rational choice as the starting point on which to build its industrialization programme. Still, it must be remembered that there is no industrial option that gives similar returns to investment in the oil sector, including petrochemicals. Saudi Arabia must still ensure that oil is produced as efficiently as possible and that the best techniques are used in recovery and exploration. Secondly, the bulk transportation of crude oil will always remain cheaper than transporting oil products. However, the comparatively greater cost of transporting oil products is still very small in comparison to the final market price of oil - so defending the Saudi decision to increase refining capacity.<sup>7</sup>

## 5.2 SECTORAL DIVISION AND DIRECTION OF EXPORTS

"Although one of the major objectives of the Kingdom's development policy is to diversify the sources of national income, oil revenue still remains the predominant contributor to both GDP and export earnings."<sup>8</sup>

The published figures of the Saudi Ministry of Finance and National Economy clearly show that oil is indeed still the major revenue producer, as table 5.3 shows. Although revenues from oil have not increased

Table 5.3 Government Revenue and Expenditure (SR million)

<u>Year</u>	<u>Oil</u>	<u>Other</u>
1974/75	94,190	5,913
1975/76	93,481	9,903
1976/77	121,191	14,766
1977/78	114,042	16,617
1978/79	115,518	17,353

continually, as "other" revenues have, in 1978/79 they still remained almost 7 times higher. However, it is interesting to note how the value of exports change and the extent to which these changes are in line with changes in volume, as table 5.4 shows. Firstly, the overall value of exports has increased more than 26 times between 1970 and 1982, from approximately SR 10 billion to SR 260 billion. Yet, the volume of exports has less than doubled, although the 'value of export' figures are nominal and not real. There are many reasons for this. After 1970 the major oil companies effectively lost control of the oil industry, as the oil producers nationalised the industry. The oil producing countries themselves asserted control over the production and marketing strategies. Table 5.4 shows that between 1973 and 1974 the value of exports increased more than four times, as a result of sharp increases in the volume of oil exports. In the following year, there was a 16.6 per cent decrease in the

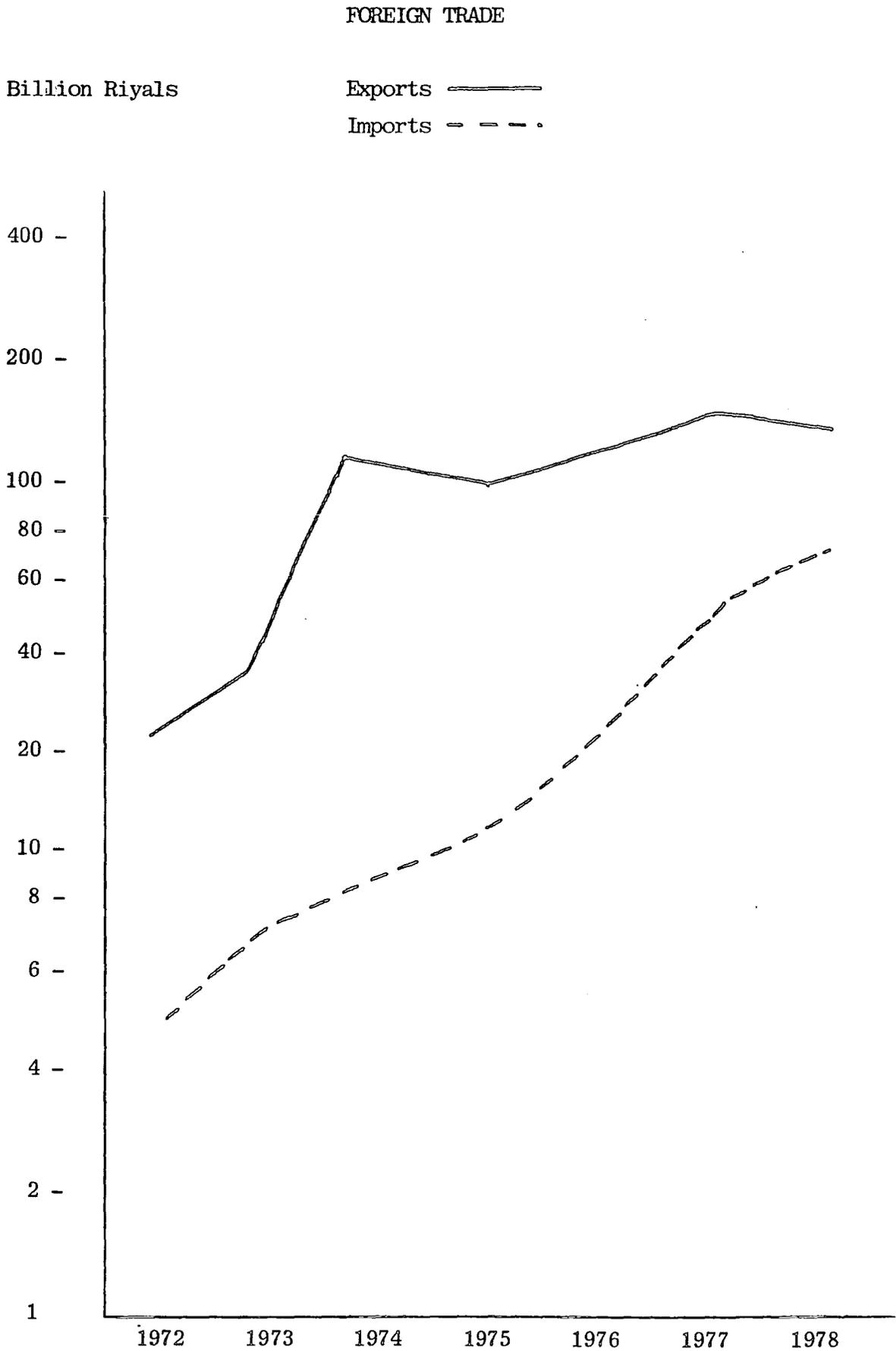
Table 5.4

Petroleum Exports and Volume of Exports

	EXPORTS (Billions of Riyals)			VOLUME OF EXPORTS (1980=100)		
	Exports	Crude Petroleum	Refine Petroleum	Petroleum	Crude Petroleum	Refined Petroleum
1970	9.89	8.27	1.61	38.8	34.8	114.9
1971	14.92	13.09	1.83	48.4	45.3	107.2
1972	18.84	16.90	1.94	61.7	58.9	114.5
1973	28.93	26.51	2.42	77.9	75.8	117.4
1974	110.54	102.34	8.20	87.1	85.6	116.3
1975	104.54	97.26	7.28	72.6	71.3	96.9
1976	136.91	127.73	9.18	88.3	87.0	113.8
1977	154.98	146.00	8.99	93.5	93.0	104.1
1978	128.56	120.16	8.40	84.0	83.2	98.5
1979	197.12	186.03	11.09	95.4	95.3	98.7
1980	339.37	320.45	18.92	100.0	100.0	100.0
1981	383.00	359.57	23.44	98.0	97.5	107.6
1982	259.93	235.16	24.77	63.4	61.0	108.3

Source: IMF, International Financial Statistics, Yearbook 1983, pp. 438-439

Table 5.5  
Graphical representation of Exports 1972-1978



volume of exports but the value of exports decreased less than proportionately by registering a 5.5 per cent decrease. The value of exports continued to increase until 1978. The volume of exports also decreased in this year, as the conservation measures taken by the industrialized nations and the persistent global recession decreased the aggregate foreign demand for Saudi oil. However, Saudi policy decisions and technical factors also played a part in decreasing exports.<sup>9</sup> Table 5.5 shows the changes in the value of exports graphically.

The figures after 1978 show the second major increase in oil prices in the 1970's. Between 1979/80 the value of exports increased more than 70 per cent, despite a mere 5 per cent increase in the actual volume of exports. Likewise, there was a 12 per cent increase in the value of exports in 1981, although the volume of exports decreased. There is a significant change in this trend in 1982 when both the volume and value of exports decreased markedly. At this time Saudi Arabia's role as the 'balancing producer' is evident. Consequently, Saudi Arabia decreased its production of oil as new supplies of oil became available when aggregate world demand was not increasing. Of course this seriously affected Saudi revenues and diversification plans and, budgets were updated.

Table 5.4 also shows how exports are divided between crude petroleum and refined petroleum exports, in terms of both the value and volume of exports. The value and volume of crude oil exports change almost totally in line with total exports, as might be expected. Crude oil exports form about 90 per cent of exports and their value has of course varied with the OPEC price adjustment and global recession. Consequently, there is a

decrease in 1975, 1978 and after 1980. Table 5.6 looks at crude oil production, as opposed to exports of crude oil (table 5.4). It is notable that overall domestic production registered decreases in the same years, suggesting overall domestic production is closely-linked with crude oil exports. This is unlike the situation regarding refined oil.

Receipts from the export of refined oil are much less significant, for example, in 1970 they represented about 16 per cent of exports and in 1982 they represented less than 10 per cent. The value of refined oil has fluctuated between 1970 and 1982 but nonetheless, there were substantial increases in 1974 and 1980 (but not in volume terms), in line with the increased price of oil. However, unlike the receipts from crude oil exports, the value of refined oil continued to rise in 1982. The picture for the volume of refined oil exports is a little erratic. In 1975 there was a significant decrease in volume, as the market responded to the abrupt increase in prices. It dropped from 116.3 in 1974 to 96.9 in 1975 (1980 = 100). The high volume of exports of refined oil from 1970 to 1975 has not been reached since. However, since 1978 there has been an increase in volume each year.

When the volume of exports of refined oil in table 5.4, is compared with the volume of production in table 5.6, it becomes apparent that production of refined oil is less closely linked to exports than is the case for crude oil. In 1972/73 domestic production shows a sharp decrease, while the volume export of refined oil shows a slight increase. Likewise, in 1976/77 and 1977/78 domestic production increases, while exports show a fall. The opposite is true in 1980/81: domestic production decreases and

Table 5.6  
Crude Oil Production and Refinery Products in Saudi Arabia

Year	Crude Oil Production 1969=100	Refinery Products 1969=100
1969	100	100
1970	118.1	132.9
1971	148.3	129.2
1972	187.6	181.1
1973	236.2	138.5
1974	263.7	193.7
1975	220.0	124.2
1976	267.4	151.7
1977	286.1	157.4
1978	258.1	167.5
1979	296.4	178.0
1980	317.1	178.1
1981	305.1	177.3
1982	201.5	183.1

Source: Central Department of Statistics, Kingdom of Saudi Arabia,  
The Statistical Indicator, 1982, Table 5.1, 5.4.

exports increase. At first glance, these variations between the volume of exports and production do seem to suggest that domestic production is linked to domestic demand as well as the export market. However, it could be that these variations are the result of stock piling and expected demand, rather than actual demand. Of course actual demand has to be estimated. Some economists suggest that exports of refined petroleum have slowed down to pre-1970 levels as a result of increased domestic consumption requirements. Also, that the Third Development Plan calls for the expansion of domestic and export refinery capacity for this reason.<sup>10</sup>

It is also suggested that there was a fourfold rise in domestic consumption/production ratios of refined petroleum products from 5.2 per cent in 1962 to 20.3 per cent in 1975. If this was the case, and it has continued, this increasing domestic demand could undermine export diversification. Unless refinery capacity increased sufficiently, then the supply of refined products would not cover export demands. Further, this contradicts the view that a buoyant domestic demand can cause economies of scale which aid exports by lowering costs.

Changes in the amounts of exports mean that the direction of exports has varied. Table 5.7 shows that Western Europe historically has been the primary recipient of Saudi oil, receiving more than 50 per cent of the total value in the 1970's. Then, this dropped to 40 in 1977 and 37 per cent in 1978, as conservation efforts took effect. Factors like the coming of North Sea oil are also of minor importance. However, recent figures from the Saudi Arabian Monetary Agency suggest a reversal of this trend, as table 5.8 shows. In 1979 Europe accounted for 40 per cent of exports and

Table 5.7

## Direction of Exports 1970-78 (value SR millions)

Region/Country	1970	1971	1972	1973	1974	1975	1976	1977	1978
Western Hemisphere, <sup>a</sup> of which:	591	1,707	2,523	4,678	17,155	14,810	21,275	28,291	29,636
United States	98	590	1,129	1,625	4,417	4,031	6,377	14,575	21,771
Europe <sup>b</sup>	4,820	8,286	12,580	17,466	65,141	45,420	55,598	60,538	51,538
Common Market (EEC) of which:	3,333	7,437	10,422	14,308	53,528	37,645	45,592	50,625	42,894
Belgium	284	351	275	595	4,351	3,090	3,480	5,237	3,990
France	692	1,662	2,111	3,061	14,570	11,290	15,582	14,704	14,776
Germany	222	578	736	1,102	5,541	3,659	4,238	4,435	3,779
Italy	1,179	1,767	2,547	3,322	11,050	7,894	8,587	11,182	9,360
Netherlands	993	1,569	2,708	3,111	3,259	5,291	6,951	8,123	6,018
United Kingdom	828	1,510	1,846	2,651	11,755	6,271	6,618	6,491	4,678
Other European, <sup>c</sup> of which:	660	949	2,158	3,158	11,614	7,708	9,930	9,912	8,641
Spain	446	543	1,220	1,830	8,139	5,205	5,704	5,579	5,468
Middle East, of which:	609	806	839	1,266	4,135	3,574	4,209	5,756	4,900
Bahrain	512	646	616	770	2,804	2,249	2,548	3,370	4,900
Asia, of which:	3,339	4,414	5,532	8,291	31,973	31,135	41,074	47,162	46,947
Japan	2,323	2,783	3,444	4,940	20,135	20,483	27,097	29,080	27,881
Africa	474	759	425	586	1,157	1,154	1,246	926	853
Oceania	309	254	214	245	1,129	1,480	1,682	2,154	1,746
Others <sup>d</sup>	765	977	650	848	5,533	6,389	10,170	8,383	2,662
TOTAL	10,907	17,303	22,761	33,308	126,223	104,412	135,154	153,209	138,242

Notes: a. Including Latin America. b. Including exports to Eastern Europe. c. Other Western European.  
d. Mainly bunker fuel exports.

Source: El Mallakh, R. Saudi Arabia: Rush to Development, Croom Helm 1982, p. 347

Table 5.8

Changes in the Direction of Exports Between 1979 and 1980 (Millions of Riyals)

Region and Country (1)	EXPORTS			
	1979		1980	
	Value	Percent	Value	Percent
WESTERN HEMISPHERE, OF WHICH:	47,532	22.3	75,130	20.7
U.S.A.	36,753	17.2	58,866	15.3
Bahamas	295	0.1	533	0.1
Brazil	6,048	2.8	9,479	2.6
Trinidad	80	-	-	-
Canada	4,001	1.9	7,183	1.9
EUROPE	85,891	40.3	150,905	41.5
E.E.C., OF WHICH:	68,239	32.0	118,577	32.6
Belgium	7,065	3.3	13,207	3.6
France	17,856	8.4	33,525	9.2
Germany	6,022	2.8	11,029	3.0
Italy	17,314	8.1	22,305	6.1
Netherlands	11,807	5.5	24,754	6.8
U.K.	7,097	3.3	12,844	3.5
OTHER WESTERN EUROPE, OF WHICH:	17,652	8.3	32,147	8.8
Greece	4,578	2.1	8,129	2.2
Spain	8,624	3.9	10,569	2.9
Switzerland	240	0.1	2,046	0.2
Turkey	85	-	326	0.1
EASTERN EUROPE	-	-	181	-
MIDDLE EAST, OF WHICH:	7,599	3.6	11,810	3.3
Bahrain	4,511	2.1	7,150	1.9
Jordan	829	0.4	1,358	0.3
Kuwait	122	0.1	176	-
Lebanon	952	0.4	1,391	0.3
Syria	126	0.1	38	-
OTHER ASIA, OF WHICH:	64,205	30.1	111,200	30.7
India	1,528	0.7	1,086	0.2
Japan	36,983	17.3	63,274	17.4
Korea, South	6,474	3.0	11,784	3.2
Pakistan	920	0.4	1,994	0.5
Phillipines	1,492	0.7	2,812	0.7
Singapore	8,394	3.9	14,109	3.8
Taiwan	3,287	1.5	5,961	1.6
Thailand	1,730	0.8	3,462	6.9
AFRICA, OF WHICH:	2,285	1.1	4,715	1.3
Somalia	44	-	65	-
OCEANIA	2,681	1.2	5,046	1.4
OTHERS (2)	2,991	1.4	4,080	1.1
GRAND TOTAL	213,183	100.0	362,886	100.0

(1) Countries listed accounted individually for over 1% of either year totals

(2) Mainly bunker fuel exports

the following year 42 per cent. One obvious factor involved was the second sharp increase in oil prices in 1979. Between 1979 and 1980 the overall nominal value of exports rose from SR 210,000 million to 360,000. Asian states, including those in East and South East Asia increased considerably their purchase of Saudi exports in the 1970's. Although still ranking second to Western Europe, they purchased 31 per cent in 1977 and 34 per cent in 1978. Again, as table 5.8 shows this trend appears to have been halted in 1979 when Asia accounted for 30 per cent of exports. Japan appears to be responsible for this decrease. In 1970 Japan received 21 per cent of total exports and in 1978 20 per cent, making this country the primary importer of Saudi Arabia crude. Table 5.8 shows that in 1979 and 1980, Japan accounted for 17 per cent, a 3 per cent reduction in Saudi exports. This decrease along with the USA increase in exports, meant that Japan and the USA imported similar values of Saudi exports in 1979.

Up to 1976 the USA maintained a 3 to 5 per cent share of the Saudi export market. Then, in 1977 it dramatically increased its market share to almost 10 per cent, in 1978 to 15 per cent and then, in 1979 exports peaked at 17.2. In this year, exports to Japan were 17.3 per cent of the total. USA imports from Saudi Arabia dropped to 15.3 per cent of the total in 1980. The major reason for this increase was the Saudi price level coupled with oil export cutbacks from Iran. The change in the distribution of OPEC oil has had considerable effects on the direction of Saudi imports. In 1976 the USA ranked only as the tenth largest importer of Saudi petroleum, having purchased less than 5 per cent of the total export value in that year. The loss of Iranian oil supplies and output cutbacks by several OPEC nations had a substantial impact. Saudi Arabia is now the foremost

exporter of petroleum to the USA. Some 16.4 per cent of the US total petroleum requirements were received from Saudi Arabia in 1976 - and 18 per cent in 1977.<sup>11</sup> This must indicate a certain amount of dependency on Saudi Arabia by the USA and therefore, trust. Given the continually unstable situation in the Middle East (in particular, the oil producers Iran and Iraq are still at war in March 1984), this situation is likely to continue. From Saudi Arabia's point of view, it may be beneficial for the USA to have this kind of stake in its future.

It has been noted in chapter 4, that due to the fluctuating world demand for oil (and in particular, OPEC oil), allocations in the Saudi budget for 1983 are 17 per cent lower than those of the previous year. This would imply that export diversification policies have yet to be implemented. Despite such major re-allocations, a senior economic analyst at a Riyadh bank is quoted as saying:

"Pessimism is not justified. The government has done a fine job in creating a solid infrastructure and developing the industrial base of the country. Oil revenue is becoming less important. The Kingdom is already less dependent on oil for budget revenue and this trend will continue."

Contrary to the belief of analysts in the western countries, the fall in oil revenue will not seriously affect the Kingdom's economic situation, argues this analyst.

"We believe that the degree of self sufficiency achieved over

the past few years - especially in agriculture - will act as a buffer against loss of oil revenue.<sup>12</sup>

Having looked at the extent of export revenue from oil in this section, it is difficult to accept this view as anything other than too optimistic.

### 5.3 JOINT VENTURES FOR EXPORT DIVERSIFICATION

As early as 1960, the Saudi Government began negotiating with foreign oil companies regarding the development of a petrochemical industry. They realised that the country was well-endowed with oil and natural gas, which was then largely flared, but that resources are finite. Still, the oil companies showed little interest so that in 1962 the General Petroleum and Mineral Organization (Petromin) was established to undertake hydrocarbon projects which did not detract private investors. State support increased for industrialisation with the ascension of Faisal Ibn Abd Al Saud in 1964. This desire to press forward with the petrochemical industry was underlined by the creation of SABIC, the Saudi Arabian Basic Industry Corporation in 1976. Again, as 5.1 shows, the Third Development Plan emphasised the need for a petrochemical industry, by calling for the production of a variety of petrochemicals, as well as fertilizers by 1985.

In the early 1970's Petromin saw Jubail as a possible growth pole for petrochemical and other industries because of the proximity of the Berri crude oil and gas field and the deepwater channel which makes it suitable for international shipping. In 1973 the Bechtel Corporation was asked to call up a master plan for Jubail. When the master plan was presented to

the Saudi Government in 1975 it was decided to establish a Royal Commission for Jubail and Yenbu, the last town being added as a second development poll. The Commission is responsible for policy. Jubail's industrial harbour is expected to be the largest in the world. By the year 2000 this Industrial City could have 300,000 inhabitants with petrochemical complexes, oil refineries, a steel mill and over a dozen other industries as well as a port area and an airport. The total investment could reach some \$40 billion. The industrialisation programme calls for large quantities of gas as fuel and feedstock. This has led to Petromin's gigantic gas gathering, treatment and transmission project. Abdulaziz A. Alzamil, the chief executive officer of SABIC has stated: "... the gas gathering we have will be much cheaper than anywhere else, and that is the whole principle behind our industrialisation, we are using a resource we have."

The industrialisation programme calls for the use of the most advanced technology and the technological leadership of the USA is accepted as paramount. However, corporations which have proprietary rights to technology are normally prepared to license their technology but at the same time, anxious not to sell it. They look for an element of management participation to maximise their returns. Anyway, to bring a new petrochemical plant on stream demands highly specialized skills, perfect co-ordination and faultless timing. These factors make a rational case for Saudi Arabia's decision to opt for joint ventures with some of the world's leading corporations.

Section 5.2 showed that Saudi Arabia has vastly increased its exports to the United States. Although U.S. demand for oil may decline by nearly 6 per cent between 1979 and 1990, US imports of natural gas are expected to increase significantly. Saudi Arabia may find a market for its petrochemicals in the USA, despite the apparent over capacity in the world market. The revolution in materials in the 1960's and 1970's meant that the petrochemical industry became \$150 billion industry worldwide. Growth in the 1980's and 1990's is expected to be more moderate, growing at about 4 per cent per annum. If there is the expected over-capacity, will the rate of return be acceptable to these foreign corporations? Some suggest that the broader picture must be considered. That is, a foreign corporation could be compensated by supplies of oil or other hydrocarbons at a specially attractive price, or supplies assured. This strategy of oil entitlements as an incentive to investment was underlined by Sheikh Ahmed Zaki Yamani in February 1980 when he stated that in future Saudi Arabia would only grant oil contracts to customers willing to help build up the Saudi industrial base.

After negotiations, 5 major US corporations showed interest - Mobil Oil, Shell Oil, Exxon, Dow Chemicals, and Celanese/Texas Eastern. The projects and corporations are listed in table 5.9. Negotiations are lengthy. The petrochemical products and the volume of output must be agreed. The various processes have to be selected. Contractors to construct the complex have to be chosen. Bidding documents have to be issued and the bids reviewed. Finally, the contract has to be drawn up including the financial arrangements. Consequently, negotiations with the 5 major corporations have been time-consuming. Below we look at an

Table 5.9

Joint Ventures with U.S.A. Corporations

(Metric tons per year)

PRODUCT	SABIC MOBILE	SABIC SHELL	SABIC EXXON	SABIC DOW	SABIC CELANESE/TEXAS
Ethylene	450,000	656,000	-	500,000	-
Low Density Polyethylene	200,000	-	240,000	68,000	-
High Density Polyethylene	91,000	-	-	105,000	-
Ethylene Glycol	200,000	-	-	330,000	-
Ethylene Dichloride	-	454,000	-	-	-
Caustic Soda	-	377,000	-	-	-
Styrene	-	295,000	-	-	-
Ethanol	-	281,000	-	-	-
Chlorine	-	330,000	-	-	-
Ethyl Benzene	-	327,000	-	-	-
Methanol	-	-	-	-	730,000

Source: Hambleton, Professor H.G., The Saudi Petrochemical Industry in the 1980's, p. 12

outline of the negotiations with Mobil. The Mobil Oil Corporation has a long established relationship with Saudi Arabia: in 1946 Mobil came to the Kingdom to produce and distribute oil under the aegis of Aramco. Already in 1974, Mobil were examining the possibility of establishing a petrochemical industry in the Kingdom in conjunction with the Saudi authorities. In 1976 an interim agreement was signed between Mobil and SABIC calling for a feasibility study, an economic assessment of the project and, negotiations for the establishment of a joint venture company. Since then, \$31 million has been spent on different related studies. Finally, on April 19, 1980 the final agreement was signed by the chairman of Mobil Saudi Arabia, the subsidiary of Mobil Oil Corporation and SABIC.

It is expected that the 725 mile East-West Natural Gas Liquid (NGL) pipeline, will carry 270,000 barrels per day. The liquids separated in Yanbu into ethane, butane, isopentane, propane and petrol. The ethane will then be sold to the SABIC/Mobil complex for feedstock and fuel at about 1/5th of the world market price. This ethane will then be used to produce 450,000 tons per year of ethylene using Mobil process and Bechtel engineering; 200,000 tons of low density polyethylene using Union Carbide process; and 91,000 tons of high density polyethylene, once again using the Mobil process. The capital cost of this project will be SR 7000-m. Mobil and Saudi Arabia would be partners, each holding 50 per cent of the equity. Each partner is expected to provide 15 per cent of the capital cost in cash. The remaining 60 per will come from the Public Investment Fund of Saudi Arabia and (10 per cent) from private banks. Crude oil entitlement is also made available by Saudi Arabia to Mobil as an added inducement.

This plant is expected to come on stream in 1985. About 300 people will be needed to staff it. Initially, 40 per cent of the employees will be Saudis and 60 per cent expatriates. By 1990 it is hoped that these percentages will be revised. Products will be marketed in Europe, along the east coast of USA, in the Arab world, in Africa and in Saudi Arabia itself. When the plant is at full capacity, it will mean that Mobil has increased its petroleum production by one third.<sup>13</sup>

#### 5.4 MARKETING PROBLEMS

Saudi Arabia has a small domestic market. This means that any industries which are large scale (and therefore, make use of economies of scale) must look for an export market. In the case of Saudi Arabia, in order to exploit the comparative advantage, this means placing emphasis on energy intensive, capital intensive industries using resources which are abundant in supply, oil and natural gas. Saudi planners have had to consider the fact that oil and gas are depletable resources and, that Saudi Arabia has a certain international responsibility to supply oil.<sup>14</sup> Consequently, the decision to develop a petrochemicals industry was taken with great caution and with the aim of converting the country's oil into higher value products.<sup>15</sup> It is unfortunate for Saudi Arabia that the global oversupply of petrochemicals, is an issue which is achieving increasing attention in the 1980's. A project may make economic sense in a tight market, yet be unjustifiable if its products are in global oversupply. Saudi Arabia's case for producing petrochemicals must be weakened by two factors. Construction costs may be at least 25 per cent more than in the United States or Western Europe because the country's

infrastructure does not permit the most efficient construction practices. Secondly, the country is a long way from the richest world markets of North America, Japan and Western Europe. Its export-orientated industries will thus have to be particularly competitive if they are to break into these established markets.

The alternative strategy is to aim for markets in Africa and Asia where the Kingdom may be closer as a supplier than the advanced industrial countries. At least initially, these markets will be less lucrative. (Anyway, according to the Mobil Saudi Arabia case study, Saudi Arabia appears to be following both strategies). In any case, it has been suggested that the Saudi Arabian output of petrochemicals will play a minor role in global consumption. The production of major petrochemicals in the free world is 86 million tons a year. It is said that the total value of the industry in the 1980's will be less than \$3 billion each year, compared with a Gross Domestic product of \$160 billion.<sup>16</sup>

The American Government is nonetheless particularly worried by the reduced demand for many petrochemical products and excess production capacity. The Financial Times reported that Mr. Donald Regan, the U.S. Treasury Secretary, warned that the Saudi Arabian petrochemical products will not be allowed into the U.S. unless they are sold at similar prices to US products. After the eighth annual meeting of the Saudi - U.S. Joint Commission on Economic Co-operation in Riyadh in October 1983, Mr. Regan is reported to have said:

"... we are for free trade ... By fair trade, we mean no subsidies and no underselling of our producers by unfair means."<sup>17</sup>

The problem lies in that Saudi Arabia is expected to account for 5 per cent of world ethylene production capacity by the late 1980's. With the current excess production and reduced demand, a number of U.S. chemical industry leaders, have been calling for further capacity cuts in order to be better prepared for the arrival of new competitors - particularly Saudi Arabia. However, Mr. Regan confirmed that the Kingdom would retain its 'most-favoured' nation status in the US. Nonetheless, the current 4 per cent US tariff on petrochemical products was supposed to drop down to 2 per cent in the next two years.

The American Government has shown even less enthusiasm for some of the Saudi efforts of import substitution. For example, from a bargaining point of view, pursuit of an import substitution strategy makes an export promotion policy less defensible. In fact, Saudi attempts to lessen its dependence on food imports are simple attempts towards self-sufficiency. They have raised some interesting questions all the same. The US Secretary of Agriculture, Mr. John Block stated during a recent visit to the Kingdom that it was 'crazy' for the Saudis to be spending billions of dollars to develop agriculture in a difficult environment. He suggested that the Saudis retreat from their "thrust to self-sufficiency at any cost"; "not to raise it if we can grow it cheaper". The Americans have recently had to reduce the amount of land used for agricultural production. The Saudi Minister of Agriculture and Water, Dr. al Shaikh retorted that if the USA

was spending billions of dollars on research to find an alternative to oil, why should the Kingdom hesitate over building a sector that would save it from asking for food from others. Both ministers are proving that politics must be considered by planners. Neither country is content in exploiting industries in which it has a simple, economic comparative advantage.

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CHAPTER 6BALANCE OF PAYMENTS

In this chapter the Saudi Arabian Balance of Payments position is examined. Any policy for economic diversification must be expected to have an impact on the balance of payments. An import substitution policy may for example actually increase the volume of imports in the short term, while export diversification may stabilise export proceeds. The balance of payments is examined in this chapter, not because of concern for the Saudi trade situation which remains basically healthy. Rather the concern is to ascertain trends with respect to particular items recorded on the balance of payments, as this enables some assessment to be made of the impact of diversification. In an economy as open as that of Saudi Arabia, diversification must be expected to have a strong balance of payments impact. Furthermore, as balance of payments statistics are more accurate than most domestic economic indicators, examination of these accounts may be the most appropriate way of assessing the overall effects of economic diversification.

In this way, the balance of trade is crucial, as one might expect from a developing economy with a predominant foreign trade sector. The current account which includes all payments made for visible goods and services, has shown a surplus every year between 1973 and 1981, with the exception of 1978, as table 6.1 shows. Usually, even the most enlightened government will regard a surplus as preferable to a deficit on its balance of trade.

A trade surplus means that foreign exchange is accumulating which could continue indefinitely without producing a crisis for that country. The country is producing without consuming to the extent of its trade surplus.<sup>1</sup> The difficulty in the case of Saudi Arabia is that the trade surplus is almost totally generated by its oil exports. These oil supplies are so vital to the world economy that small changes in price or volume can have far-reaching effects.

Chapter 6 attempts to provide some insight into table 6.1 which shows the Balance of Payments Summary for Saudi-Arabia between 1973 and 1981. There are 2 major divisions: the Current Account and, Capital Movements. As stated, the former includes all current purchases of goods and services, that is visibles and invisibles. The visibles refer to goods, physical items and the invisibles refer to services like shipping payments and insurance. Capital Movements, on the other hand, simply refer to all other transactions not recorded in the Current Account, such as capital transfers and foreign exchange. In this chapter, these divisions are accepted and followed.

### 6.1 MERCHANDISE TRADE

Line 1a of table 6.1 shows that revenues from oil between 1973 and 1974 more than quadrupled. Only the 1975 and 1978 figures show a decrease. The 1975 figure reflects the decreased demand for oil in response to the abrupt change in the oil price and also as industrialised countries felt the effects of the recession. This decrease in the volume of exports of crude oil and refined oil production is shown clearly in table 6.2. The

Table 6.1

Merchandise Trade 1973-1981 (Million Riyals)

	1973	1974	1975	1976	1977	1978	1979 <sup>r</sup>	1980 <sup>r</sup>	1981 <sup>p</sup>
1. Merchandise trade									
f.o.b.	14,813	103,293	74,889	89,122	90,430	57,692	115,880	241,126	258,529
a) Oil exports	21,583	115,684	95,597	125,350	141,807	125,265	194,459	334,543	372,685
b) Other exports	98	283	418	428	431	490	504	519	541
c) Imports	-6,868	-12,647	-21,116	-36,656	-51,808	-68,063	-79,083	-93,936	-114,697

r: Revised

p: Provisional

Source: SAMA, Kingdom of Saudi Arabia Annual Report 1981 p. 158.

Table 6.2

Exports of Crude Oil and Refined Oil Production 1969-1982

Years	Index No. 1969 = 100	Exports (1000 U.S. Barrels)
1969	100.0	1178260
1970	117.3	1382056
1971	146.2	1722145
1972	186.8	2200635
1973	235.4	2773346
1974	263.3	3102244
1975	219.4	2584651
1976	266.9	3145401
1977	282.7	3330437
1978	253.9	2991051
1979	289.3	3408068
1980	301.8	3556128
1981	295.9	3486825
1982	191.3	2254477

Source: Central Department of Statistics, Kingdom of Saudi Arabia, The Statistical Indicator, 1982, Table 5-8.

figures for 1976 and 1977 show steady increases in oil revenues but the situation changes again in 1978. In 1978 there was a decrease in production, probably an attempt by the government to maintain the real price of oil. The following year both oil revenues and production increased to meet the shortfall of Iranian production because of the revolution there. Table 6.2 again shows this change in the production and volume of exports more clearly.

At the end of 1979, revenues from oil exports also benefited from an approximate 33 per cent rise in oil prices.<sup>2</sup> Table 6.2 shows only small volume changes in the export of oil, yet table 6.1 shows an almost doubling of oil revenues which must be a result of the increase in the price of oil. In 1979 oil exports were SR 194,459 million and in 1980 SR 334,543. However, increases in revenue from oil exports are unlikely to continue. Table 6.2 shows a 30 per cent decrease in the volume of oil exports from 1980 to 1982 (and table 5.4 in chapter 5 shows more than just a decrease in oil exports in these years).

Line 1b in table 6.1 looks at "other exports" showing a less dramatic picture. The economy relies almost totally on oil for its visible export earnings. Comparisons between revenues from oil and non oil exports show this. In 1973 "other exports" were 0.45 per cent of oil exports and by 1981 the situation had deteriorated even further when they represented only 0.15 per cent of oil exports. Other exports include dates, skins, wood and fur. It appears that up to 1981 the country's export diversification aims achieved little success in comparison with oil exports. Nonetheless, between 1973 and 1981 other exports have increased more than five times.

This will not surprise the Saudi Government. As outlined in chapter 5, the government only gave priority to its aim of export diversification in the Third Plan period, 1980 to 1985. Only in this latest plan have specific policies been discussed for achieving a successful export diversification policy. The 1981 SAMA Annual Report admits that in the meantime other exports constitute a negligible amount, particularly with the inclusion of natural gas liquid (NGL) in oil export.<sup>3</sup> This situation is expected to change in the short term. By 1985 many of the Saudi petrochemical projects based at Yanbu and Jubail are expected to come on stream. One of the reasons for developing the petrochemicals industry is to achieve greater 'value added' from oil related exports. With this in mind, increases in the figure for other exports should be substantial.

Gains from refined products are increasing, as table 6.3 shows. Of the total oil exports of SR 375.8 billion, refined products accounted for

Table 6.3: Oil Exports in 1980 and 1981

	In millions				
	<u>1980</u>		<u>1981</u>		<u>% change</u>
	<u>\$</u>	<u>Rls</u>	<u>\$</u>	<u>Rls</u>	
Crude	96,325	340,444	104,099	352,375	10.0
Refined, of which	5,096	16,953	6,933	23,468	38.4
bunker fuel	858	2,854	933	3,158	10.7
GRAND TOTAL	101,421	337,397	111,032	375,843	11.4

Source: SAMA Annual Report 1981 Kingdom of Saudi Arabia p. 42.

about 5 per cent, bunker oil (described in 6.2 Services and transfers of this chapter) for about 1 per cent and crude oil for the balance of about 94 per cent. However, in general the Third Plan accepts that crude oil exports will maintain their central importance domestically as well as internationally.<sup>4</sup> Domestically, they will continue to provide financial cover for the Kingdom's expenditure budgeted from 1980-1985, the exchange needed to pay for imports and other current capital account payments abroad, including foreign aid and the continued strengthening of the Kingdom's international financial reserves. Internationally, crude oil and other hydrocarbon exports will maintain their stabilising role in the world economy and supply of energy.

Imports, 1c of table 6.1, have a significant note to play in the Merchandise trade account. Figures for imports show a substantial increase between 1973 and 1981. However, the rate of increase has varied quite considerably. There were very substantial increases in imports 1973/74, 1974/75 and 1975/76. Nevertheless 1976/77 and 1977/78 shows a slowing down in the increase in the demand for imports. After 1978 there was a marked drop in imports which was only temporary and in 1979/80 and 1980/81 there were increases in the rate of increase. Clearly, there is a high propensity to import in Saudi Arabia but a number of factors have combined to produce such an unsteady increase in the rate of increase of imports. (Determinants of imports were examined in chapter 2 using regression analysis. The two factors which were positively related to the level of imports were private consumption and government consumption.)

Table 6.4 looks at the total value of exports, imports and the Balance of Trade. It shows a continuous run of figures for the years 1968 to 1982 but it

must be noted that the figures are nominal, rather than real figures. Nonetheless, table 6.4 shows that changes in imports were not substantial up to 1972, after which the changes in the price of oil took place. From 1972 to 1976 there were large changes in imports showing a short lag effect before the demand for imports responded to the substantial improvement in the financial restrictions. During the mid 1970's the Kingdom's limited port capacity constrained imports as well as the short run absorptive capacity of the economy, given the shortages of manpower and local skills. The decrease in the rate of increase between 1978/79 probably shows the government's attempt to control inflation. Finally, the increase in the rate of increase of imports reflects the loosening of financial restrictions resulting from the increase in oil revenues at the time. The conclusion must be that without the oil revenues, the demand for imports would not have increased in the 1970's so dramatically, but other factors played some part in affecting the rate of increase.

Table 6.5 gives some indication of which sector has increased its demand for imports. It divides imports into 3 sectors, the oil sector, the public sector and the private sector, and looks at the annual increase in the growth of imports. Table 6.5 gives figures c.i.f, that is, they include the cost of insurance and freight whereas table 6.1 gives figures f.o.b, that is, on a free on board basis. Thus, the figures in table 6.5 are upward biased compared to those in table 6.1.

Table 6.5 shows that demand for imports by the oil sector almost trebled between 1975 and 1981, although these imports account for only 2 or 3 per cent of the total. Since the oil sector is reliant on imports for its capital

Table 6.4

Total Value of Exports, Imports and Balance of Trade 1968-1982

(Million S R)

Years	Balance of Trade	Imports	Exports
1968	+ 6469.9	2803.9	9273.8
1969	+ 5641.6	3361.5	9003.1
1970	+ 7426.6	3197.0	10623.6
1971	+ 14886.6	3667.9	18554.5
1972	+ 18052.8	4708.3	22761.1
1973	+ 25998.8	7310.3	33309.1
1974	+116073.7	10149.2	126222.9
1975	+ 89588.6	14823.1	104411.7
1976	+104462.8	30690.7	135153.5
1977	+101546.6	51662.0	153208.6
1978	+ 69062.0	69180.0	138242.0
1979	+130960.0	82223.0	213183.0
1980	+262536.0	100350.0	362886.0
1981	+286183.0	119298.0	405481.0
1982	+131755.0	139335.0	271090.0

Source: Central Department of Statistics, Kingdom of Saudi Arabia.  
The Statistical Indicator 1982 Table 6-1.

Table 6.5

Imports (CIF) by Sectors (Million Riyals)

	Oil Sector	Public Sector	Private Sector	Total	% Growth
1976	1,093	11,823	31,072	43,988	81.1
1977	1,380	13,161	47,627	62,168	41.3
1978	4,481	14,039	61,115	79,635	28.1
1979	2,927	11,000	78,599	92,526	16.2
1980	2,808	10,596	97,442	110,846	19.8
1981 <sup>p</sup>	2,976	15,866	116,500	135,342	22.1

p Provisional

Source: Kingdom of Saudi Arabia. SAMA Annual Report 1981 p. 43.

equipment this is not surprising. However, the 1978 figure of SR 4,481 million is not easily explained. Tabel 6.2 shows an increase in oil production in 1976/77 of 266.9 to 282.7 but 1977/78 shows a decrease to 253.9 (1969 = 100). This clearly cannot account for the upsurge in imports demanded by the oil sector. According to the SAMA Annual Report for 1981, the SR 4.5 billion registered in 1978 was due to the gas gathering and processing project and the crude oil and NGL pipeline networks.

The public sector increased its demand for imports from SR 11,823 million in 1976 to SR 15,866 million in 1981, as table 6.5 shows. However, there was not a steady increase in demand. In 1979 and in 1980 there were significant decreases in imports. This marks the Government's determination to control "imported inflation" by removing some of the upward pressure on prices. More significant than public sector imports, are private sector imports that is, those financed through the commercial banks. Private sector imports account for well over two thirds of total imports in each year between 1975 and 1981. Unlike oil sector and public sector imports, private sector imports have increased every year. In fact, after 1976 private sector imports accounted for more than three quarters of total imports. This shows that the Government's policy of encouraging the private sector to take the lead, rather than be dominated by the public sector, has met with some success.

Overall, the Merchandise trade account has increased more than fifteen times between 1973 and 1981, from SR 14,813 million to SR 258,529 millions. This visible trade surplus is almost totally dependent on oil exports, thus, 1975, 1978 and 1982 figures show substantial decreases in the surplus.

## 6.2 SERVICES AND TRANSFERS

The Services and Transfers account, the invisible account is best divided into Receipts and Payments, as in table 6.6. Firstly, we look at Receipts which are divided into three by Investment Income, Oil Sector (bunker oil) and "Other" positive receipts. Of these 3 factors, investment income is clearly the most influential so that receipts are largely a function of investment income. Investment income represents returns from Saudi investments made abroad. It is the receipt of interest and dividends on loans and investments in foreign countries which provide foreign exchange. The figures for investment income in table 6.6 between 1973 and 1981 record a staggering increase, from SR 761 million to SR 35,614 million. Even between 1973 and 1974 there was more than a five fold increase from SR 761 million to SR 4325 million. The underlying reason for this is oil revenues, once more. Thus, in 1977/78 when oil revenues dropped, there was no increase in investments, so investment income was more or less constant. With the abrupt change in its financial position in the 1970's, one of the more obvious and straightforward options for the Saudi authorities was simply to invest their incomes in western financial markets.

Oil sector receipts, 1 b of Services and transfers in table 6.1, shows quite a steady increase between 1973 and 1981. However, like oil exports in the Merchandise trade account, it shows two significant drops in receipts in 1975 and 1978. As with oil exports, this shows demand responding to the price change. Table 6.3, above shows bunker fuel (oil sector) as part of the overall composition of oil exports and it may be seen that it represents less than 1 per cent. 1c) of the Services and transfers account in table 6.1 shows

Table 6.6

Services and Transfers and the Current Account Balance (Million riyals)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1989<sup>r</sup></u>	<u>1980<sup>r</sup></u>	<u>1981<sup>p</sup></u>
2. <b>Services and Transfers</b>	-5,479	-21,303	-24,553	-38,708	-48,459	-65,200	-78,649	-103,380	-114,483
1 - <u>Receipts</u>	2,873	9,238	11,259	16,121	21,190	21,987	25,935	37,482	50,186
a) Investment Income	761	4,325	6,539	10,277	14,057	14,622	16,518	24,761	35,614
b) Oil Sector (bunker oil)	793	2,616	1,755	2,047	2,168	1,843	2,561	2,854	3,158
c) Other	1,319	2,297	2,965	3,797	4,965	5,522	6,856	9,867	11,414
2 - <u>Payments</u>	-8,352	-30,541	-35,812	-54,829	-69,649	-87,207	-104,584	-140,862	-164,669
a) Freight & Insurance	-687	-1,267	-3,167	-7,332	-10,360	-11,572	-13,443	-16,910	-20,645
b) Oil Sector Investment Income	-1,267	-17,380	-5,676	-7,788	-8,621	-3,954	-6,943	-23,011	-23,065
c) Other Private Services	-1,960	-2,591	-6,036	-9,659	-13,528	-24,338	-26,839	-22,095	-27,239
d) Other Government Services (1)	-2,991	-7,468	-18,988	-26,556	-31,831	-37,671	-46,053	-65,326	-77,855
e) Private Transfers	-1,447	-1,835	-1,945	-3,494	-5,309	-9,672	-11,306	-13,520	-15,865
3. <b>Current Account</b>									
Balance (1-2)	9,334	81,990	50,336	50,414	41,971	-7,528	+37,231	+137,746	+144,046

(1): Including official transfers and contributions or capital subscription to international or regional development agencies.

r : Revised

p : Provisional

Source: SAMA, Kingdom of Saudi Arabia, Annual Report 1981, p. 158.

other receipts. It too shows an annual increase between 1973 and 1981 but particularly large increases 1973/74 and 1979/80, showing its close connection with oil revenues.

In short, Receipts of the Services and transfers account are largely a function of investment income. Investment income in turn is largely governed by oil exports so that oil revenues are a major factor in this part of the invisibles account. Or rather, this has been the case so far. There are some signs that investment income may eventually move counter-cyclically to oil income. When oil prices fall economies of the west are more buoyant. For a given amount of investment, there is a larger income. Specifically, if oil prices decline, there is more bank borrowing in the west as economies revive which causes an upward movement of interest rates, as more credit is demanded. As net depositors, this benefits the Saudis. Foreign investments can be seen as a form of diversification, with benefits accruing as oil revenues fall. The question must be asked: Is this preferable to local diversification? Local diversification affects the Saudi populace directly, whereas foreign investments only earn revenue and so has a less direct affect.

The Payments part of the Services and transfers account is less simple. These are payments made by the Saudi Government and therefore, all show a negative sign. Payments are divided into five parts: a) freight and insurance b) Oil sector investment income, c) Other private services, d) Other Government services, and e) Private transfers. Payments for freight and insurance increased from SR 687 million in 1973 to SR 20 645 million in 1981, a thirty fold increase (in current prices but not constant prices). From table 6.2, it may be seen that exports of oil have risen from 2.8 billion

barrels (thousand million) to 3.5 billion barrels for the same years respectively. Increased insurance payments must play a significant role in the increase of freight and insurance payments, as an increase in the volume of oil exports is an insufficient factor alone to account for the increase in freight and insurance payments. This is shown in the figures for 1974/75. Although less oil is exported, payment for freight and insurance more than doubled. This must imply that Saudi importers are paying freight and insurance costs, and not just exporters.

Payments for oil sector investments have increased (and decreased in 1975 and 1978) largely in line with oil exports. Between 1973 and 1981 oil sector investment payments increased from SR 1,267 to SR 23,065 million. However, between 1973 and 1974 oil sector investment payments increased more than 13 times, largely reflecting compensation to the western oil companies when they were nationalised. The following year therefore saw an immediate drop to SR 5,767 million. There was also a decline in investment income payments to SR 3,954 million in 1978 probably because less money was available to invest. In 1980 there was a dramatic increase in these payments to SR 23,011 million. At this time the government was making its petrochemical industry a priority and this increase may reflect these investments.

Line 2c of the Services and transfers account in table 6.6 shows other private services. Like imports of the Merchandise trade account, other private services are not entirely dependent on oil exports. These payments are for services like consultancy fees charged by engineers, designers, architects and the like. These private services did not decrease (in line with oil exports) in 1975. In fact, the rate of increase between 1974/75 is

larger than 1973/74. Due to ambitious planning in the post 1974 period, payments to foreign consultants increased remarkably. When oil revenues then fell, consultants still had to be paid. However, there is a decrease in 1980 when oil exports are increasing. It may be that payment for private services, that is, payments by the non oil private sector are being diverted to oil sector investment payments, where there was more than a three fold increase at this time. In other words, private sector investors became more involved in the oil sector.

Other Government services includes official transfers and contributions or capital subscription to international or regional development agencies. With the exception of 1974, other Government services makes the largest contribution to the payments part of the Services and transfers account. In 1973 other Government services represented 35 per cent of total payments and by 1981 they represented 47 per cent of the total. This was mainly due to a substantial rise in foreign aid given by Saudi Arabia.<sup>7</sup> It is estimated that between September 1974 and June 1975 the Saudi Fund for Development disbursed loans valued at SR 579 millions<sup>8</sup> and this generous effort to help less developed countries has been continued.

Private transfers also show an upward trend between 1973 and 1981, however, it accounted for 17 per cent of payments at the beginning of this period and under 10 per cent at the end. This is mainly due to the increasing proportion of payments accounted for by other Government services. The major part of private transfers represents non Saudis working in Saudi Arabia and sending a large part of that income to their families in their home country. After 1975, and the implementation of the Second Development Plan 1975 - 1980,

private transfers increased quite sharply. They were SR 3494 million in 1976 compared with SR 1945 million in 1974. (Private transfers may well have increased even more, but because some of the transactions were handled by the money-changers, they were not all recorded). This rise in transfer payments reflects the increase in numbers of expatriate workers to construct the infrastructural projects, like roads and airports. Although there appears to be quite a steady increase upto 1981, this is expected to level off during the 1980's as the Third Plan attempts to consolidate the numbers of non Saudis working in Saudi Arabia and use them only in selective industries. The reasons for the planners concern for the numbers of expatriates working in Saudi Arabia can be appreciated by comparing the figures for private transfers: between 1975 and 1980 private transfers increased almost 7 times from SR 1,945 to SR 13,520 million.

### 6.3 THE CURRENT BALANCE

The current balance in table 6.6 is the Merchandise trade account (table 6.1) plus the Services and transfers account and therefore represents a summary of the two. By the early 1980's it was difficult to remember how small the Saudi economy was little more than a decade earlier and additionally, how quickly it had grown.<sup>9</sup> The Current Balance reflects this and so varies largely in line with oil exports. The current account surplus increased from SR 9,334 to SR 144,046 million. Notably, the current account surplus increased almost 9 times in 1973/74 which was entirely attributable to the increased revenues resulting from higher oil prices. Imports only doubled during this time and without the dramatically increased payments for investments in the oil related sector, the surplus would have been higher. In

Table 6.7

Capital Movements and Reserves 1973-1981 (Million Riyals)

	1973	1974	1975	1976	1977	1978	1979 <sup>r</sup>	1980 <sup>r</sup>	1981 <sup>p</sup>
4. Capital Movements & Reserves	-9,334	-81,990	-50,336	-50,414	-41,971	7,528	-37,231	-137,746	-144,046
a) Oil sector capital transactions & other capital transactions (net)	-2,315	-13,245	6,564	-1,397	2,757	1,893	-4,538	-10,633	-11,428
b) Other private capital (net) <sup>1</sup>	-3,627	-4,957	+1,013	-4,783	-6,334	-11,752	-23,232	-28,455	-22,531
c) Commercial banks (net) <sup>2</sup>	+51	-317	-467	-1,789	-3,319	+1,458	-5,242	-12,353	-10,903
d) Official capital & reserves	-3,443	-63,471	-57,446	-42,445	-35,075	+15,929	-4,219	-86,305	-122,040

1. Including inward direct investment, short-term private capital and net errors and omissions.

2. Includes changes in total foreign assets of SAMA, i.e. gold, foreign exchange (including currency cover) and investments (including loans to developing countries and international financial institutions).

r: Revised

p: Provisional

Source: SAMA, Kingdom of Saudi Arabia Annual Report 1981 p. 158.

1975 the surplus was lower reflecting the lower oil revenues and the expansion in imports. Because the Saudi domestic economy was so small at this time, the loosening of financial restrictions inevitably led to an increase in imports. It was also in this year that Saudi Arabia cut the link between the riyal and the dollar because of the continued depreciation of the latter. The move was an attempt to maintain the real value of its oil receipts by stabilising the price of imported goods from the industrialised world.<sup>10</sup>

In 1976/77 the surplus on the current account was reduced to SR 41,971 million. This is due largely to an increase in imports and also an increase in payments made for freight and insurance, and payment for private services. A deficit was recorded in 1978 in line with the reduction in oil exports and also as a result of an increase in payments, and private services in particular. It seems that the private sector was becoming more active after 1976 which provided some encouragement for the Government's economic diversification policies.

The current account immediately returned to surplus in the following year but this surplus was only a quarter of that recorded in 1980 and 1981. In the latter year, merchandise exports reached SR 372,685 million as a result of both oil prices and production being high. It is likely that the 1982 cut in volume will lower income, as well as the current account surplus considerably.<sup>11</sup> The continued growth in payments for goods and services will make this even more likely.

#### 6.4 CAPITAL MOVEMENTS AND RESERVES

The Capital Account has four major elements: capital transactions, other private capital, capital movements by commercial banks and, most importantly, official capital and reserves. (Table 6.7 shows these inflows and outflows on the capital account). When the uses to which foreign exchange is put and the sources to which foreign exchange came are added up, the overall accounts of all international payments must balance.<sup>12</sup> In other words, the capital movements and reserves account acts to compensate a surplus or deficit on the current account. The official capital and reserves element of this account acts as the major compensating factor and so its movement in general co-incide with oil exports.

4a of table 6.7 shows oil sector capital transactions and other capital and is the net situation, reflecting flows in and out of the country. This section is mostly long term capital movements and represents the Saudi search for highest rates of return from abroad. In the Saudi case it often means investment in western financial markets which has been an easier option than investing in local industries. This account was only positive in 1975, 1977 and 1978 which means that usually the Saudis invested more abroad than they repatriated back to Saudi Arabia. This is despite the increase in profits made by the oil companies after 1973. In 1973/74 there was almost a 6 fold increase to SR 13,245 million reflecting the availability of money to invest. However, as oil revenues decreased in 1975 and in 1978, and less money was available, the capital transactions account is positive. More capital is flowing into Saudi Arabia than is going out. Although in 1981 the outflow rose to SR 11,428 million, it is expected to fall in 1982 reflecting decreased

oil revenues, as well as increased investment in the domestic petrochemical industry.

Other private capital includes inward direct investment, short term private capital and net errors and omissions (which are more or less unavoidable). Short term capital holdings arise in many ways. Traders' receipts and expenditures cannot be perfectly synchronised and hence they hold transactions and precautionary balances to pay bills that are due. In the case of Saudi Arabia, the imports bill is a high one so this factor is significant. Nonetheless, it is notably that other private capital is only positive in 1975 (SR 1013 million), reflecting oil revenues once again. Net private capital was SR 3,627 million in 1973 and SR 22,531 million in 1981, reaching SR 28,455 million in 1980. 4a) and 4b) represent inward and outward investment in Saudi Arabia, the latter being non oil investment entirely. If the Government is to achieve success with its export diversification policies, the private capital part might be expected to become positive, especially as increasing numbers of foreign firms participate in ventures with the Saudi Government. It might be that the 21 per cent decrease between 1980/81 reflects a new trend of increased investment in Saudi Arabia. However, the situation to date does not indicate that there has been a great deal of success in attracting external capital for domestic industry.

4c of table 6.7, Commercial bank transfers include changes in total foreign assets of SAMA, that is, gold, foreign exchange and investments. 4c and 4d, official capital and reserves, are manipulated by the government to offset the current account position. Initially, most of the foreign assets were held as short term financial assets, consisting of bills with a thirty

day or ninety day maturity or, demand deposits with central banks and commercial banks in the USA and Europe. This was the case until the mid 1970's because the Saudi technocrats handling the oil revenues had little knowledge of stock markets in the West. However, they did regard property investment as secure.<sup>13</sup> These deposits caused problems for the banks selected, as Arab depositors withdrew large amounts from one bank, and placed it in another. The Saudis themselves lost when the sterling was devalued in 1967 and from the depreciation of the dollar in the 1970's. From 1975 to 1976 outflows from the commercial banks increased almost four times to SR 1,789 million, representing greater overseas asset holdings.

It is inevitable that the increasingly larger balance of payment surpluses that have accrued to Saudi Arabia during the 1970's, have resulted in the steep growth of SAMA's foreign assets and reserves. Now these assets largely consist of foreign securities, which is a major component of international reserves.<sup>14</sup> The growth of 4d roughly reflects oil revenues. Between 1973/74, 4d increased 18 times and between 1977/78, the situation changed from an outflow of SR 35,075 to an inflow SR 15,929 million. By 1981 the outflow reached SR 122,040 million. Thus, in the 1970's and particularly after 1975, Saudi Arabia has been playing an increasingly important role in international financial markets. In May 1980 the International Monetary Fund (IMF) made an agreement whereby it could borrow upto SDR 8 billion over a period of 6 years for SAMA. (In 1979 1 SDR = SR 4.2825). The IMF considered the agreement to be a substantial contribution to the re-cycling process, strengthening both the Fund itself and the international monetary system. At the same time, Saudi Arabia's IMF quota was doubled to SDR 2.1 billion and it was given a permanent seat on the IMF executive board.<sup>15</sup>

Finally, table 6.8 looks at official reserves in Saudi Arabia between 1973 and 1981, that is, the stock of reserves (not the flow). In 1973 reserves were SR 18,040 m and by 1981 reserves reached SR 484,170 million. Reserves increased more than three times between 1973 and 1974, and in 1975 reserves doubled, reflecting the increase in oil revenues, as stated above. With the exception of 1978 when there was a relatively small decrease, reserves continue to rise throughout the period to 1981. When the data in table 6.8 is

Table 6.8 Official Reserves (million riyals)

1973	18,040
1974	78,940
1975	138,370
1976	184,460
1977	215,210
1978	204,430
1979	218,180
1980	313,830
1981	484,170

Source: IMF, International Financial Statistics Yearbook 1983 pp. 438-439  
 looked at in relation to table 6.7, a general pattern emerges, especially after 1976. When the capital account registers an outflow, there is a stock increase. This was the case in 1979 when there was a capital account outflow of -SR 37,231 and an increase in reserves to SR 218,180 million.

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## Conclusion

Following the substantial increase in oil revenues, the immediate aim of the Government was to utilise those revenues efficiently. The size of the revenues and of the Saudi Arabian population encouraged the Government to adopt policies for economic diversification. Unlike Kuwait with a population of less than 1.5 million, Saudi Arabia was in a position to draw up both import substitution and export diversification plans. The Government began to implement these plans firstly by strengthening the country's infrastructure, as outlined in the Second Development plan period 1975-80.

The Government turned its attention directly to economic diversification in the Third Plan period 1980-85. The limited, existing domestic economy forced the Government to depend on imports to develop the economy further. Consequently, the demand for imports has been increasing rapidly since 1974. Linear regression analysis revealed that government consumption was the major determinant of imports and capital fixed formation was negatively related. This was disappointing because it suggested that the increase in imports are apparently not contributing to future development. It also shows that the Government can control the demand for imports to some extent, useful when revenues decrease, as in 1983.

The examination of industrial licenses discussed in chapter 3, suggested the Government has achieved some success in implementing its

import substitution policies. This was the case in construction-related industries in the First Plan period. After 1980, it appeared that import substitution was taking place for durable goods and transport goods, a good foundation for economic diversification. Given the limited domestic market, some positive steps have thus already been taken towards the implementation of import substitution policies.

The need for foreign participation is an issue in Saudi Arabia's diversification plans. There has been a marked decrease in foreign participation after 1980 in import substitution plans, as the examination of industrial licenses showed. Although it means that Saudi Arabia is not attracting foreign investment, it may reflect the Government policy giving priority to Saudi Arabians in the awarding of contracts. The development of the labour force is nowhere near completion. Some observers say that the Government should have started by developing the labour force; attitudes take decades to change. In the meantime, despite ambitious policies to limit the role of expatriates, they still have an essential role to play in the services sector, and in the Government policies for export diversification.

It is rather too early to assess the success of the export diversification policies. Against oil exports, non oil exports have achieved little success. Although non oil exports have increased more than five times between 1973 - 1981. It is too early to judge because many of the large scale, capital intensive petrochemical plants are only coming onstream this year. These plants are so unpopular with existing western suppliers that success seems likely. In any case, the Government has

founded its export diversification plans on well known economy theory by exploiting the available comparative advantage.

Finally, Saudi Arabia is now facing much tighter financial constraints than it did in 1980. It is already causing some difficulty, and is slowing down the implementation of economic diversification plans.. This is not all bad. A case can be made to suggest that the rationalisation of all Government plans is exactly what is needed, given the low financial constraints of the past decade.

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