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# Development Strategies for Saudi Arabia: Escaping the Rentier State Syndrome

*Strategic Insights*, Volume III, Issue 3 (March 2004)

by [Robert Looney](#)

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One definition of an economist is somebody who sees something happen in practice and wonders if it will work in theory.

Ronald Reagan

## Introduction

An economic irony that is gaining increasing attention is the "resource curse" effect, whereby many of the poorest and most troubled states in the developing world have paradoxically the highest levels of natural wealth.<sup>[1]</sup> In fact, a growing body of literature that suggests resource wealth itself, especially where it accounts for the bulk of government revenues as in the case of the so called "rentier states"<sup>[2]</sup> may harm a country's prospects for development. Country growth data bear this out: rentier states, with greater natural resource wealth, tend to grow more slowly than their resource-poor counterparts.<sup>[3]</sup>

In fact this "rentier state" effect is beginning to manifest itself in what are commonly thought of as some of the wealthiest regions of the world.<sup>[4]</sup> In the Gulf, for example, relatively stable levels of oil production and flat oil revenues, combined with an unanticipated rapid increase in population, have resulted in declining per capita income in Saudi Arabia. At the height of the oil boom in 1980s the kingdom's per capita income was around \$17,000. By 2003 this figure had declined to about \$8,200, lagging far behind most of the other Gulf oil producers.<sup>[5]</sup> This decline is even more pronounced if corrected for inflation and the decline in the dollar exchange rate.

The sharp decline in per capita income has occurred in an environment of increased unemployment. While the overall unemployment rate of around 8 percent is of some concern, the unemployment rate among young Saudis is estimated to be anywhere from 15 to 30 percent. Even worse, the unemployment rate among new graduates (in the age group of 20-24) is striking — these first time job-seekers have an unemployment rate of 27 percent for men and 33 percent for women. It is hard to comprehend how this state of affairs developed in a country which is the world's largest oil producer with one-fourth of the world's proven oil reserves. Clearly a youthful population with increasing numbers of job seekers facing growing rates of unemployment has the potential of becoming a full fledged economic crisis, perhaps severe enough to destabilize the regime and bring a new era of uncertainty to the kingdom.

No doubt the boom and bust cycle that has characterized Saudi Arabian economic growth since 1973/74 has been an additional factor underlying the kingdom's poor job creation record. Oil revenues, representing 85-90 and 75-80 percent of total exports and budgetary receipts respectively, are both volatile and insufficient for funding development projects needed to stimulate needed levels of private sector investment.

In fact, the government's finances dictate that it will be able to absorb only a small fraction of the new labor force entrants, thus leaving the private sector as the only significant source of new job creation. Based on the historical patterns of investment, growth and new job creation, only robust investment led non-oil GDP growth of in the range of five or six percent can absorb the yearly influx of job seekers. In recent years, the private sector, while showing many encouraging signs of vitality, has not been up to the task, growing at rates considerably below this: 0.9% (1995), 4.9% (1996), 4.5% (1997), 2.6% (1998), 4.2% (1999), 4.3% (2000), 3.7% (2001), and 4.4% (2002).[\[6\]](#)

Developing a dynamic private sector is critical because much of the slow down in employment and non-oil growth has stemmed from the decline over time in the government's ability, simply through its own expenditures, to stimulate private sector output and expenditure.[\[7\]](#) In addition, the Kingdom's current approach to employment creation, the Saudization program, while well intended has a somewhat limited potential to make a significant contribution to the country's employment needs.[\[8\]](#)

The sections below contend that the keys to revitalizing the non-oil economy are diversification, modernization, and increased competitiveness across the whole spectrum of private establishments.[\[9\]](#) To complement progress in these areas, development strategies are suggested that are likely to further enhance the kingdom's employment creation potential through shifting resources towards those sectors with the highest job creation potential.

### **Reoriented Development Strategies**

The oil/gas sector and the petrochemical industry continue to dominate the economy in general and the manufacturing sector in particular. This phenomenon can be characterized as a single-track development strategy, with focus on the modern-export oriented segment of the economy.

Diversification in non-hydrocarbon industrial activities has started but is still relatively modest, with a strong concentration in food, textile, furniture and household appliances. Since the oil/gas/hydrocarbon sectors are largely capital intensive, they are not a dynamic source of jobs, at least of the magnitudes currently needed. Stronger diversification into more labor intensive activities is needed and should proceed based on the exploitation of comparative advantages such as location and natural resources. Here, small and medium sized firms, often neglected or overlooked in the past, can play a leading role in solving the kingdom's employment problems.

### **Programs for Small- and Medium-Sized Firms**

In many countries, small-and-medium-sized enterprises (SMEs) have played a crucial role in creating jobs and providing economic stability. In Thailand, for example, a whole new development model has centered on SMEs playing a leading role in advancing the economy. The results have been stunning, with growth accelerating over the last several years, and projected to reach eight percent in 2004.[\[10\]](#)

In Saudi Arabia's case, SMEs have the potential to play a variety of important roles: (a) selling their own products, usually finished goods, (b) acting as either subcontractors for or (c) suppliers of raw materials for larger multinational enterprises. There are several great success stories in creating a large number of jobs and relatively low costs. For example, the information technology (IT) job market is booming in Saudi Arabia, many positions filled by Saudis working for SMEs.[\[11\]](#) Currently, SMEs in Saudi Arabia represent almost 93 percent of total enterprises and account for about 24.7 percent of total employment.[\[12\]](#)

### **Problems Confronting SMEs**

Unfortunately the IT sector is the exception. In Saudi Arabia, small (less than 59 employees) and

medium sized (60-99 employees) businesses to date have not lived up to their potential for a number of reasons.[\[13\]](#) Extensive surveys carried out by the Council of Saudi Chambers of Commerce and Industry (CSCCI) and the United Nations Industrial Development Organization document the main concerns of businessmen:[\[14\]](#)

*Lack of credit/finance/capital* The effective cost of capital is often quite high because regular lending institutions have a hard time evaluating new businesses, especially those production areas with which they are not familiar. As a result, lending institutions often require guarantees or collateral beyond the means of the borrower. Most SMEs in the kingdom are not satisfied with the existing banks/financial institutions. They find loan procedures very complicated. Most of them are unable to meet the demands for personal guarantee and securities. Most SMEs also contend that, compared with the terms given to the country's larger, more established firms, banks are generally too rigid with their terms, existing loan procedures are too cumbersome, and there is too much difficulty obtaining loans.[\[15\]](#)

*Dependence on foreign resources* Ironically, given the ability of SMEs in many developing countries to create local jobs, many Saudi SMEs create very few. As part of the country's Saudization program, whereby the percentage of the jobs held by Saudi nationals was to reach 30 percent by the end of 2003,[\[16\]](#) many of these companies have managed only marginal progress — two percent on average in the case of very small enterprises.[\[17\]](#) As is often the case, imported capital and technology have, in effect, made many SMEs dependent on foreign technicians and manpower. Because of the pervasiveness of imported equipment across the kingdom, many companies face tight labor markets for skilled workers.

*Access to technology* On the other hand, the digital divide is a significant problem for many SMEs in Saudi Arabia.[\[18\]](#) Improving access to technological networks of international standard can be very expensive and out of reach for many SMEs.

*Limited marketing skills* Many SME managers in Saudi Arabia have little in the way of formal training in marketing and product distribution, even by developing country standards. As a result, their operations often cannot take advantage of economies of scale and are high cost. They are limited to local rather than export, or even national markets. In a survey of 60 existing SMEs in the Eastern Province of Saudi Arabia by Small & Medium Enterprises Development Council (SMEDEC), EPCCI in the year 2000, over 75 percent of the enterprises reported problems in marketing.[\[19\]](#) While, in the kingdom, many of these obstacles are more perceived than actual, they have had the effect to stifle the growth of SMEs.[\[20\]](#)

*Bureaucratic hindrances* While some progress has been made in cutting bureaucratic red tape, as late as 2001, the Middle East Economic Digest noted that

Approvals can take a long time in Saudi Arabia, and tax the patience of even the hardiest entrepreneur. In the water sector, for example, there is currently no tariff, no regulator, no law and no credible counter-party, so private financing is impossible. Such legal complications may take years to clarify.[\[21\]](#)

The cost of complying with national and international standards can also be very expensive for SMEs. This will be especially the case when Saudi Arabia joins the World Trade Organization (WTO), where compliance with government commitments (such as TRIPS) can make it difficult for SMEs to comply.

*Limited information on possible markets and clients* Many Saudi SME owner/operators have little experience in exporting to foreign markets. Similarly, they have difficulty identifying and attracting foreign investors. As a result, their firms are often under-sized and cannot expand in line with growing markets.

Compounding these problems is the fact that, because of their lack of access to credit, Saudi SMEs are usually the most vulnerable in times of economic recession. The resulting business failures often add to the severity of the recession. This problem will only be compounded as the economy moves to a freer price system with the country's ascension to the WTO in 2004 or 2005.[\[22\]](#)

### **Suggested Initiatives**

Unfortunately, government policy towards SMEs has not been as extensive or as effective as it should and could be. A 2001 report noted that "despite the importance of SMEs in the economy, these are unable to benefit from the incentives provided by the government and, due to their small or medium size, commercial banks view them as high risk borrowers and refrain from funding their needs."[\[23\]](#)

Given the great potential for job creation in SMEs, government policy initiatives are clearly warranted. Areas for special emphasis should include:

1. *Training/human resource development* — this covers both on-the-job training and the broader education system. There is a strong need to improve skill bases in a range of areas.
2. *Funding for research and development* — SMEs lack assistance both for developing new ideas and turning these ideas into commercial products.
3. *Addressing weaknesses in transportation and infrastructure* — this can affect access to markets and business revenue (telecommunications, ports, airports, road networks).
4. *The encouragement and creation of alternative financial sources* — Islamic financial institutions, such as Modarabas in Pakistan, could play an important role in providing financial capital on equitable terms in accordance with Islamic codes.[\[24\]](#)
5. *Improving knowledge of the legal environment for SMEs* — The government has established a series of legal regulations and provides a number of instruments to support domestic industry. Unfortunately, because they are now aware of their options, many Saudi SMEs work under restrictive licensing agreements with foreign partners. This often prohibits the SMEs from exporting, and forces them to rely on foreign managerial and technical skills. Consequently these firms, rarely undertake product and process innovation. By subsidizing e-commerce legal services and related online information the government could enable more advantageous contracts for local firms.[\[25\]](#)
6. *Securing property rights* — One area that the government should seriously consider examining in detail is the extent to which property rights can be more formalized and legalized. As noted above, one of the main constraints entrepreneurs face in Saudi Arabia is collateral for loans. To what extent is this problem due to the legal system's failure to provide secure titles? Once entrepreneurs have secure titles to assets, the world of credit opens up because assets can be used as collateral for credit. The amounts may be significant. De Soto and his colleagues estimated the amount of "dead capital" in untitled assets held by the world's poor as at least \$9.3 trillion.[\[26\]](#)

The authorities appear aware of many of the issues confronting SMEs and are beginning to respond with effective programs. In particular, the 2004 national budget allocates substantial funding for the newly established Loan Guarantee Fund (LGF). The LGF is charged with granting credit to SMEs at the grass root level.[\[27\]](#) If the LGF can demonstrate its effectiveness in this regard, it could become a prime tool in attaining the kingdom's employment creation goals.

A major advantage of pursuing a strategy favoring SMEs is that their development would most likely provide much better regional balance in incomes. Currently, high incomes are relatively concentrated in the industrial cities of Jubail and Yanbu, the capital, Riyadh, and the financial and diplomatic center, Jeddah. SMEs would bring jobs and higher incomes to many of the towns and villages bypassed by the Kingdom's petroleum-based growth.

## Return to Unbalanced Growth

Saudi Arabia's development strategy has changed considerably over the years. Initially, after the 1973/74 sudden increase in oil prices and vastly expanded revenues, the government pursued what is often referred to in the literature as unbalanced growth.<sup>[28]</sup> This particular strategy entails investment in social overhead (mainly infrastructure) investments. The projects were attractive to the authorities since they used imported labor, raw materials and management. In addition they were highly visible.

The theory underlying this strategy is that it would minimize the amount of decision making needed in the private sector.<sup>[29]</sup> Massive infrastructure investments, by making profitable investment opportunities readily apparent, would induce the private sector to greatly step up its investment. In short, the strategy took into account the massive financial resources of the government as well as the limited entrepreneurial skills of the private sector.

In retrospect, the strategy was well conceived and began paying fairly high dividends around 1979. This approach to the Kingdom's development allowed the non-oil economy to sustain fairly respectable growth rates, even during the period of relatively slack oil revenues in the mid-late 1980s.<sup>[30]</sup> Its main flaw, however, was its underestimation of the extent to which the kingdom would remain dependent on an expatriate workforce.

Investment on social overhead capital on the scale seen in the late 1970s/early 1980s has not been replicated. Whereas public investment accounted for around two thirds of the overall growth of fixed capital formation between 1970 and 1990, investment by the private sector constituted around 83 percent of the total investment between 1991 and 2003.<sup>[31]</sup> In recent years, the government has been unable to fund another significant round of infrastructure expenditures, given that around 85% of public expenditure in the budget is allocated to the salaries of government employees and current pensions.

With time, the private sector has expanded to the point where diminishing returns to infrastructure have no doubt set in, hence the observed inability of government expenditures at this time to induce significant amounts of either private sector output or expenditures.<sup>[32]</sup> In essence the initial post 1973/74 infrastructure imbalance has been neutralized by subsequent private sector activity over the years to the point where an implicit cost subsidy to the private sector no longer exists.

Clearly, a return to the unbalanced growth development strategy of the 1970s and early 1980s would expand private sector investment and growth to the point where significant improvements in job creation would be sustainable. It would also create, through increased investment profitability, opportunities to nurture and develop the kingdom's stock of entrepreneurs.

The financial costs of this strategy are staggering, however. If the country's population continues to expand as projected, the kingdom will be home to 38.5 million people by 2023. The government has concluded that to effectively respond to the country's infrastructure needs will necessitate the mobilization of investments worth SR1,000 billion in the coming twenty years, suggesting a yearly average of SR50 billion. This includes investments of around SR438 billion in the power sector, capital needs of SR340 billion for building water and sewage projects, around SR100 billion for the gas initiative, and the remaining funds of SR122 billion for projects in the areas of telecommunication, roads, airports and related transportation systems.<sup>[33]</sup>

Financing this level of expenditures is possible, but it will require several initiatives:

1. The lending capacity of Saudi domestic banks has remained around SR11 billion a year in the last five years through 2001, and this capacity is not expected to change significantly in the coming years. Therefore, the need to mobilize domestic and

- international private capital has become essential for the development of these projects in order to satisfy growing demand in the country.[\[34\]](#)
2. Clearly, the government will have to redirect expenditures toward economic services, perhaps at the expense of salaries.[\[35\]](#)
  3. Major efforts will have to be undertaken to improve the efficiency of government services and the creation of a modern tax system.
  4. Semi-privatization of infrastructure through financial arrangements along the lines of existing and successful build operate and transfer (BOT) programs will have to become the norm in the kingdom.[\[36\]](#)

### **Adoption of a Dual-Track Development Strategy**

The undertaking of a major new infrastructure expansion program should, by reducing production costs, provide a very significant stimulus to private sector investment. To assure that this incentive is not neutralized by insufficient consumer demand, the Saudi authorities should seriously consider establishing a "Dual Track" development model focused on achieving a more balanced economy.[\[37\]](#)

### **Problems Associated With the Existing Oil Based Development Model (OBDM)**

Many of Saudi Arabia's employment problems stem from the normal difficulties associated with over-reliance on oil exports. The mechanism that has probably gained the most attention in academic circles is the so-called Dutch Disease. This phenomena has two effects, both of which have affected the Saudi economy at one time or another.[\[38\]](#)

The first focuses narrowly on the exchange rate. In technical terms, the "Dutch Disease," named after the experience of Holland, where increased gas revenues in the late 1950s resulted in the strengthening of the Guilder and the resulting loss of export markets and deindustrialization, refers to the potentially adverse effects of a booming export sector on the performance of other exports and of industries competing against imports. In the case of Saudi Arabia the real exchange rate appreciation resulting from a ramp up of oil exports is likely to reduce the profitability and competitiveness of traditional agricultural exports. It would also encourage imports of food and raw materials, which may compete with domestic production, while discouraging the emergence of new manufacturing exports, essential for the successful diversification of the economy and the creation of jobs.

The second effect of concern for Saudi development is that, during periods of modernization and expansion of the oil or gas sectors, the rest of the economy may be "crowded out" from access to key factor inputs. The hydrocarbon sector with its financial resources would preempt these resources weakening the ability of the private sector to invest and diversify. In the current context, this problem may develop when the government's new gas expansion projects are undertaken.

Another series of oil-related problems stems the fiscal implications of fluctuating and uncertain revenues. While one cannot say that oil revenues create a certain set of fiscal policy rules, it is a fact that, for the most part, Saudi Arabia and the other Gulf countries have used fiscal policy in a pro-cyclical stabilization pattern. The net effect has been to intensify the detrimental impact that fluctuations in oil prices have on the domestic economy.

In addition, oil exporters' budgetary patterns tend to be an extreme version of the fiscal rules used in many developing countries facing fluctuating revenues. Many of these countries initiate expanded capital expenditures during periods of rising revenues, on the assumption that these revenues are sustainable. When revenues decline, budgetary cuts occur, but in a fairly predictable manner (see Hicks and Kubisch, 1984). In general, social sectors are less vulnerable to cuts than defense and administration, which in turn are considerably less vulnerable than production and infrastructure.

Of course, these patterns can be affected by the willingness of countries to assume increased governmental debt in an attempt to maintain programs during periods of declining revenues. Another complicating factor, especially for Middle Eastern oil exporters is their large budgetary commitment to defense expenditures. These factors combine to produce a budgetary pattern typified by the kingdom which consistently allocates around thirty percent of its budget to defense. In Saudi Arabia:[\[39\]](#)

1. Typically increases in planned defense expenditures come largely at the expense of economic services. These reductions carry over to transportation/communications and infrastructure as well.
2. Economic services, transportation, telecommunications and other infrastructure are also reduced when the government experiences unanticipated increases in the fiscal deficit.
3. On the other hand, the country's extensive subsidy program is often funded with unanticipated increases in the fiscal deficit.
4. Allocations to human resource development are increased along with expanded defense expenditures.
5. In addition to economic services, the government tends to reduce allocations to municipal services and public lending programs during periods of expanded defense expenditures.

As noted above the net effect of these budgetary priorities has contributed to a decline in the overall strength of government expenditures in stimulating growth of the non-oil domestic economy. In part, this stems from the stop and start nature of many infrastructural projects and the generally low priority given economic expenditures during periods of austerity. In addition, increased levels of public indebtedness have no doubt come at the expense of increased private sector investments.

The budgetary and exchange rate patterns associated with the OBDM model has manifested itself in a pattern of growth that has set the oil exporters apart from non-oil Middle Eastern countries:

1. Looking at the Middle East as a whole, oil-exporters have sustained an average output growth per capita of 0.83 percent. This has been the result of a growth in physical capital of 2.24 percent and in human capital 1.96 percent.
2. These growth rates occurred in an environment characterized by a negative growth in total factor productivity of 1.22 percent.
3. In contrast, non-oil exporters in the Middle East grew about twice as fast (1.59 vs 0.83), invested at a rate about twice that of the oil exporters (4.94 vs. 2.24), and had a positive ratio of total factor productivity per output (1.55 vs -1.15).
4. As in the Saudi Arabian case noted above, the oil exporters allocated a proportionate amount of resources to human capital (1.96 percent vs. 1.86 percent for the non-oil producers).
5. Other oil exporters experienced similar patterns, with stagnant growth (0.07 percent) and total factor productivity per worker declining by 1.74 percent per annum.

While these results should be taken with caution, the dismal performance of oil exporters is undeniable. Their established pattern of total factor productivity (TFP) is especially troubling, with oil exporters averaging significantly lower rates of TFP than their non-oil counterparts ([Table 1](#)). Basically, total factor productivity reflects technological change and the ability of economic agents to respond efficiently to price signals in a continuing search for lower costs and greater competitiveness. In this regard, Saudi Arabia has had one of the lowest rates of total factor productivity, averaging negative values over much of the period since 1960. If Saudi Arabia wants to achieve better economic performance than the oil-exporter norm, the authorities will have to create an environment that encourages and even forces sustained levels of positive total factor



productivity — which is apparently an extremely difficult if not impossible task if confined to the OPDM model.

### **Development of a Second Track**

There is still great controversy over the best way to stimulate total factor productivity. For some analysts, increased competition, privatization and greater incentives for risk-taking are key. For others, the establishment of supporting institutions — a sound financial system and efficient, equitable tax systems — play a central role. The sections above have noted Saudi Arabia's progress in several of these areas. Given the experiences of other oil producing countries, however, it is not apparent that these measures, while desirable in and of themselves, are capable of restructuring the economy in a manner consistent with the employment demands currently facing the Kingdom. An alternative is to pursue simultaneously with the OBDM model a second track more focused directly on the domestic economy and SMEs.

The rationale for the two track strategy is straightforward: most developed countries have a smaller proportion of exports to GDP than do Saudi Arabia and the other Gulf oil exporters. Therefore, they are less vulnerable to external shocks like a slowdown in the U.S. or world economy, or a drop in oil prices due to surges in non-OPEC production.

Even non-oil developing countries are moving in the direction of a dual track model. Malaysia, for example, has come to the realization that its economic model before the Asia Crisis (1997) placed too much emphasis on FDI and mass manufactured exports. Now the country is looking for more balanced growth. In particular, the government is focusing on a steady strengthening of domestic demand and diversifying the sources of growth. On May 21, 2003, a US\$1.9 billion economic package was announced with about half of the expenditure allocated to grass-roots initiatives to boost domestic demand. As in most developing countries, these expenditures tend to have strong multiplier effects on domestic income and jobs. The announced initiatives are to support small and medium sized enterprises, agriculture, rural development, and new housing for the masses.[\[40\]](#)

As with Malaysia and several other East Asian countries, this second track of the Kingdom's development efforts must focus on the job creating potential of SMEs. Stress on SMEs would not come at the expense of the oil/hydrocarbon industry; the kingdom can pursue a dual track development strategy with foreign investment flowing into larger, hydrocarbon based enterprises and to a lesser extent SMEs. This first track would continue its role as the prime foreign exchange earner.

The second track would be the more locally based SMEs utilizing natural resources and skills to produce for an expanding domestic market. As noted above, an increase in Saudi employment, such as that produced by Saudization, would complement this strategy as the replacement of expatriates by Saudi workers also creates a much larger domestic demand multiplier.

The idea is to stimulate domestic demand in the short run through increased government expenditures, while simultaneously searching for new local industries to develop as part of the diversification away from OBEM activities.[\[41\]](#) At the same time, domestic-market-focused policies can achieve structural change by assisting business in moving up the value added chain, thus keeping ahead of direct competition from the other GCC countries.

### **Assessment**

The last several years have seen a number of positive elements in the government's approach towards the private sector. Most important seems to be the realization that a rapidly growing private sector is essential if any significant progress is to be made in attacking the country's unemployment problem and job creation needs. The previous sections outlined several areas that

need greater attention in the country's reform program, as well as strategies that might be considered to attain greater job creation capacity.

Taken as a whole these policy initiatives have the potential to not only significantly expand domestic employment opportunities, but perhaps more importantly do so through the creation of a virtuous cycle with feedbacks between the domestic market and the labor markets.

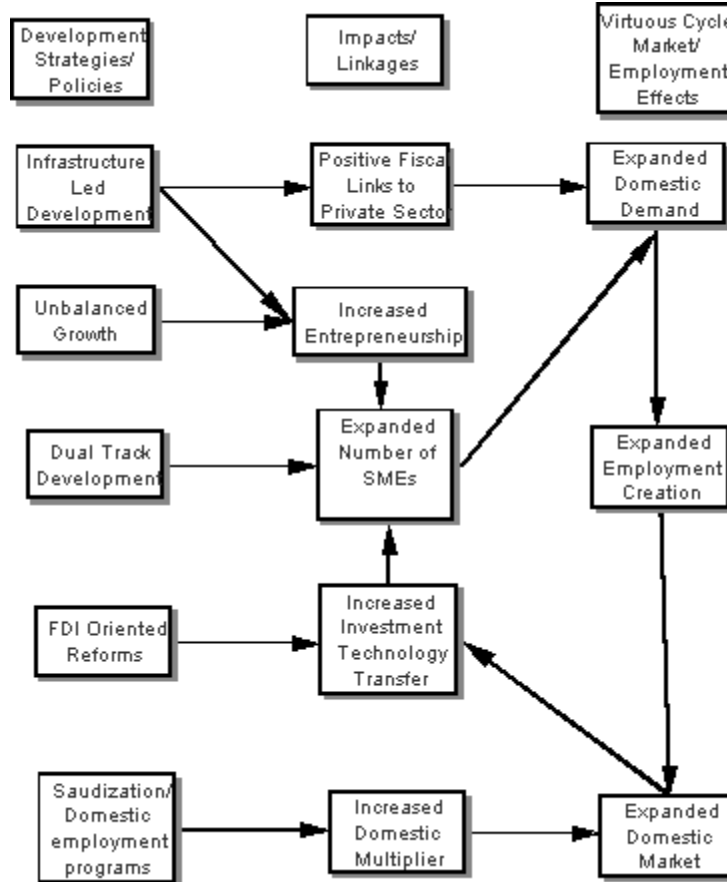


Figure 1

Drawing together then the main arguments developed above, a virtuous cycle of demand- and investment-led employment creation can be created (Figure 1) through the following process:

1. Shifting government expenditures back to a infrastructure led investment strategy should restore the positive links between government expenditure and private sector output and expenditure.[\[42\]](#)
2. Infrastructure-led development can be expected to open up a number of profitable areas of investment, stimulating increased entrepreneurship.
3. Within this context, the shift to a dual track development strategy with a focus on small- and medium-sized enterprises (SMEs) would assist the creation of new firms and associated employment.
4. Relaxing many of the disincentives to foreign direct capital would assist in providing these new enterprises with another source of capital, as well as special technologies, to take advantage of the new investment opportunities.
5. The Saudization process, by redirecting higher percentages of wages and incomes to the domestic market, would provide added demand for a wide range of domestic consumer goods.[\[43\]](#)

6. Once the process is underway, several links between added employment and further demand creation would reinforce in a virtuous cycle-type mechanism the employment creation capability of the economy.

Many challenges and uncertainties remain, however. Globalization, driven by liberalization and new technologies, provides opportunities and challenges for the dynamics of private sector activity in Saudi Arabia. On the one hand, it creates greater access to markets, technology and foreign partners, but on the other, stronger competition, which is now based not only on price but on quality, delivery and innovation.

To respond positively to these new conditions of competition, Saudi firms and industries will continuously need to improve their product and process technologies and to respond rapidly to changes in markets and competition. This in turn will require access to information, knowledge and skills, strong networking with buyers and suppliers and an effective legal and regulatory framework. The financial system will have to be greatly strengthened to cope with the rapidly increasing demands placed on it. Competitiveness will have to show marked improvements for the positive forces of globalization to offset the negative. Most importantly, government must be prepared not only to implement its current reform program, but, more importantly, to vigilantly extend and deepen it as new and unanticipated challenges present themselves.

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32. Robert Looney, "Measures of Transition from a Rentier State." In *Iran, Iraq and the Arab Gulf States* Joseph Kechichian, ed. (New York: Palgrave 2001): 131-160.
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34. *ibid.*
35. "Complacent Budget Shuns Challenges," *Oxford Analytica*, 4 December 2002.
36. Since the early 1980s developing countries have used build/operate/transfer (BOT) contracts for infrastructure development. Basically a company will build operate and, after a profit is made, transfer the project to the government for possible privatization. The terms are usually laid out in specific formal contracts between the usually foreign company and the host government.
37. As a possible analogy, in the East Asia Context dual track strategies are used to diversify away from the East Asian Development Model which is skewed toward mass manufacturing for the export market. See for example, Daniel Lian, "Malaysia: A Positive Dual-Track Economics Package," *Morgan Stanley Global Economic Forum*, 23 May 2003; and Robert Looney, "Thailand's Thaksinomics: A New Asian Paradigm" *Strategic Insights*, 2, no.12 (December 2003).
38. Robert Looney, "Real or Illusory Growth in an Oil Based Economy: Government Expenditures

and Private Sector Investment in Saudi Arabia," *World Development* 20, no.9 (September 1992): 1367-1376.

39. Robert Looney, "Saudi Arabia's Economic Challenge," *Japanese Institute of Middle Eastern Economies Review* (Autumn 1996): 37-56.

40. Daniel Lian, "Malaysia: The Laggard Could be Ready for a Spurt," *Morgan Stanley Global Economic Forum*, 6 August 2003.

41. Domestic demand is to be stimulated with deficit financing. However this must be closely controlled to avoid inflationary pressures and associated Dutch Disease problems.

42. The weakening of the links between government expenditure and private sector output and expenditure are documented in Robert Looney, "Can Saudi Arabia Reform its Economy in Time to Head off Disaster?" *Strategic Insights* 3, no. 1 (January 2004).

43. Robert Looney, "Saudization and Sound Economic Reforms: Are the Two Compatible?" *Strategic Insights* 3, no.2 (February 2004).