REFINING

STRATEGIC THINKING AND MANAGING CONTINUOUS CHANGE - 2006

A PERSPECTIVE ON THE SAUDI ARABIAN ECONOMY POST WTO

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Overview

Å The Saudi Economy in a Snapshot

Å Where is the Pessimism then?

Å Current Finances ï Meeting Future Challenges

Å Diversifying the Economy

Å Privatization

Å Saudi Arabia and Globalization ï What do Foreign Experts Think?

Å WTO and Globalization

Å Peering into the Future - - -

A. THE SAUDI ECONOMY IN A SNAPSHOT

Key Data	1995	2000	2001	2002	2003	2004	2005
Nominal GDP (SR Bn)	503	706	686	707	797	939	1,153
Real GDP (SR Bn)	485	632	636	637	686	721	795
GDP Per Capita (SR)	28,700	34,300	32,500	32,700	36,015	41,445	51,000
Oil Prices (WTI) $/b	17.25	30.61	25.76	26.57	29.0	41.33	51.00
Current A/c Balance (SR Bn)	(39.0)	53.70	35.1	44.5	111.2	193.2	360.0
Govt. Budget Balance (SR Bn)	(34.8)	45.0	(26.9)	(21)	45.0	107.0	214.0
Govt. Domestic Debt (SR Bn)	382	616	640	660	665	614	495(e)
As % of Real GDP	78.7%	97.4%	100.6%	103.6%	96.9%	85.1%	62.2%
Official Foreign Reserves ($ Bn)	68.5	73.4	82.1	77.3	95.0	128.0	177.5
Cost of Living Index (%)	0.6%	(1.0%)	(0.8%)	(0.4%)	0.5%	0.2%	0.7%
TADAWUL Index (Year end closing)	1,100	2,258	2,430	2,518	4,437	8,206	16,712

VE MAKE OUT OF IT THEN?

ÅGovernment Finances ï Seemingly in good shape. After running persistent deficits, there have been larger surpluses since 2002.

ÅBalance of Payments ï Persistent larger surpluses since 2000, with 2005 being a record year of nearly $100 billion.

ÅFinancial Markets ï Deepening and strengthening with new foreign market entrants and new products (Insurance, Islamic Sukuks).

ÅCapital Markets ï Up and up and away but ñBlack Marchò.

Å Consumer Confidence ï No formal consumer confidence index exists, but can be gauged by the number of ñcranesò on the horizon. ï Bullish real estate, sales figures. Market crash?

Å Inflation ï What inflation? Lucky to be living in Saudi Arabia - - -

Å Educational Reforms ï New private universities, foreign strategic alliances on horizon, vocational and technical training emphasis.

Å Economic Reforms ï accelerated pace, structural reforms, accountability and more transparency.

- External Relations and New Global Partners – East Asian Strategic Alliances – China, India, Malaysia, Pakistan. Others working closer with Saudi Arabia – Russia, Brazil. Relations with USA on even keel again.

- Economic Diversification – Non-oil (GDP) now running at around 60%, new industrial centers and economic zones, petrochemicals given a boost, services now a larger sector of the economy (finance).

- Globalization – Joined the WTO at last in November 2005, FDI more aggressively pursued, SAGIA road-shows etc.

- International Recognition – Blessings of Moodys, Standard + Poor, Fitch. Higher ratings for Kingdom BBB+ (A- Banking Sector)

PESSIMISM THEN BESIDES STOCK MARKET FLUCTUATIONS?

- Saudi Arabia CAN BEST BE DESCRIBED AS BEING ñSo Rich and Yet So Poorò Why?
- Despite massive hydrocarbon and mineral reserves, declining per capita income, only sustained by exceptional good ñOIL YEARSò - - -
- Despite diversification of economic base, still reliant on oil and oil-related products for exports (around 85%).
- Despite massive government subsidies, yet so little on internal R&D to develop a knowledge-based, sustainable economic infrastructure.

But there is light at the end of the tunnel.

ÅHow do we change the Economic Fundamentals to lead to Self-Sustained Growth?

ÅDepends on Two Critical Factors:

- Conditions, or pre-conditions, for sustained growth
- Engines of Growth

udi Arabia: necessary conditions for growth

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

Adapted from *the Arab World Competitiveness Report* 2002 ï 2 003. pp. 10 - 11

2: Saudi Arabia: Engines of growth

Factor	*Component*	*Saudi Arabian Setting*		
Engines of growth		**Low**	**Medium**	**High**
• Start-ups and entrepreneurship				
	- Administrative barriers to start ups			X
	- Venture capital availability	X		
	- Loans available with low collateral		X	
• Capital accumulation				
	- National savings rate		X	
	- Investment rate (Gross Fixed Capital Formation)	X		
• Taxation				
	- Low income tax rate		N/A	
	- Low corporate tax rate (foreigners only)	X		
	- Low value added taxes		N/A	
	- Tax system perceived to improve competitiveness		N/A	
• Innovation				
	- Highly rated research institute	X		
	- Business conducts R+D	X		
	- Close collaboration between universities and businesses	X		
	- Government supports research	X	X	
	- High expenditure on R+D	X		
• Transfer of technology				
	- Foreign direct investment brings new technology		X	
	- Licensing pursued to obtain foreign technology			X
• Export diversification				
	- Exports other than national resources	X		

Source: Adapted from *Arab World Competitiveness Report* 2002 - 2003

T FINANCES ï MEETING FUTURE CHALLENGES

ÅThe 2005 Actual Government Revenues were SR555 Billion. The forecast was SR280 Billion

ÅThe 2006 forecast is for Government Revenues of SR390 Billion.

ÅIs this realistic?

ÅHave the golden ñboomò days come back for good?

ÅCan current expenditure levels be sustained from government oil revenues?

ÅThe picture is mixed - - - - -

udi Actual Vs. budgeted revenues and nditures comparison 1996-2006

Year	Budgeted Revenue	Actual Revenue	Realized Revenue surplus/deficit	Budgeted expenditure	Actual expenditure	Realized expenditure deficit/surplus	Overall budget def/surplus
1981	340	368	**+28**	298	284.6	+13.4	83.4
1982	313	246	**(67)**	313	245	-68.0	+1.0
1987	103	103.8	**+0.8**	159	173	-14.0	-69.2
1992	151	169.6	**+18.6**	181	211	-30.0	-41.4
1994	120	129	**+9.0**	160	163.7	-3.7	-34.7
1996	132	178.8	**+46.8**	150	198.1	-48.1	-19.3
1997	164	205.5	**41.5**	181	221.3	40.3	-15.8
1998	178	143	**+(35)**	196	189	+7	-45.0
1999	121	147.5	**+26.5**	165	183.8	-18.8	-36.3
2000	157	248	**+91**	185	230	-18	+45.0
2001	215	230	**+15**	215	255	-40	-25.0
2002	157	204	**+47**	202	225	-23	-21.0
2003	170	295	**+125**	209	250	-41	+45.0
2004	200	392	**+192**	230	285	-55	+107
2005	280	555	**+275**	280	341	-61	+214
2006(e)	390	547(e)	**+157**(e)	335	370(e)	-35(e)	+177(e)

Sources: Ministry of Finance, and (e) estimate based on 9.3 million barrels/day, at $48 p.b. and SR 50 bn of non oil revenue, and oil exports of $160 billion (SR 602 billion) 2005. Oil exports were $163 bn (SR 611 billion).

Population Growth and Revenues ï A Ballooning Dilemma

ÅSaudi population growth is still one of the highest in the region @3.6% p.a., down from nearly 4.0% levels.

Å70% of the population under 30 years.

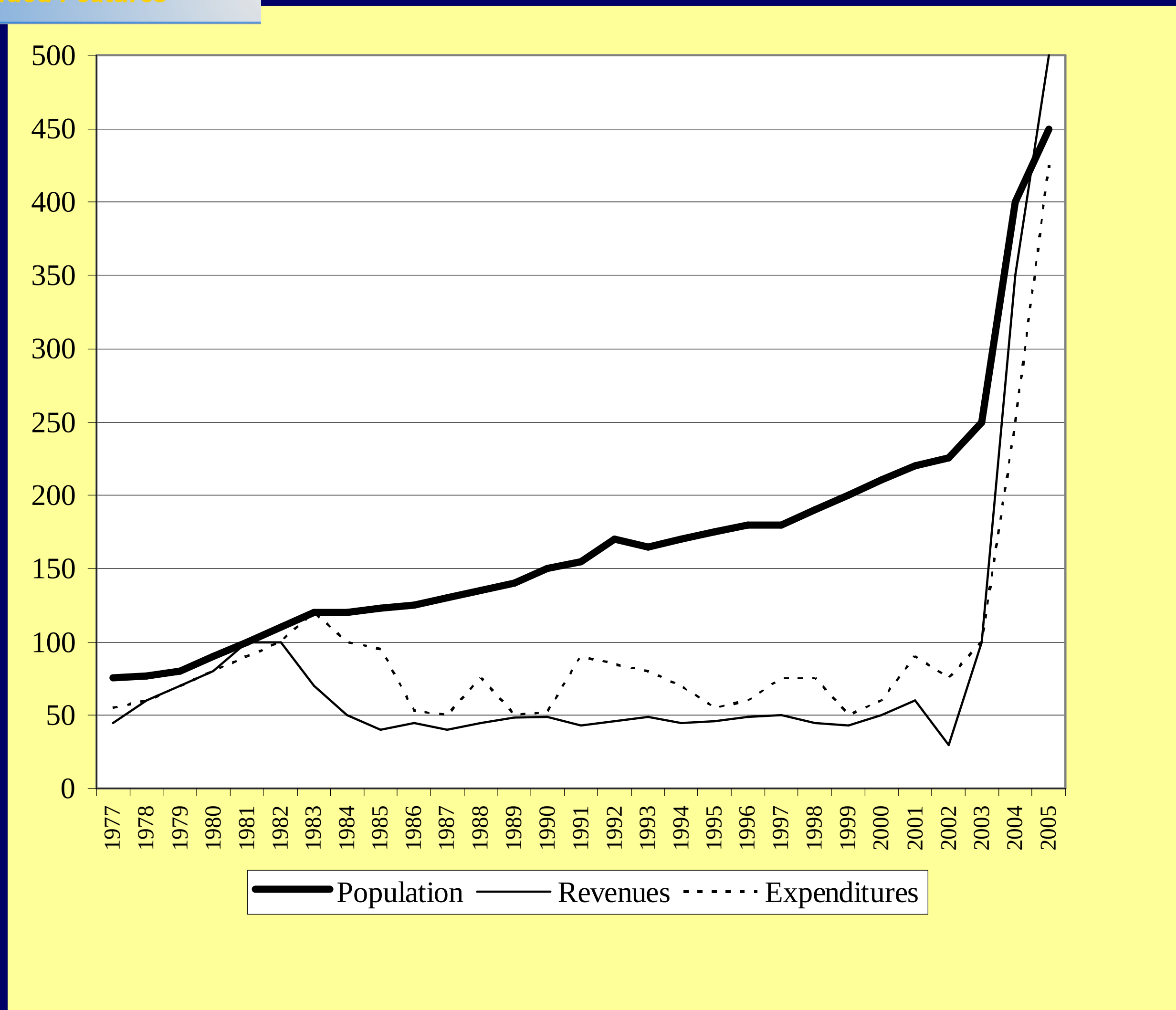
ÅIssue of managing rising expectations and needs - - -

ÅWill projected revenues meet these?

ÅHow will these issues be tackled?

- Education
- Family lifestyles
- Female participation in labor force

ure 1 Population and revenues



Source: Adapted from SAMBA, 2002.

Note: Population and government finances data rebased to an index with the base year 1980 = 100. Lines represent relative change from the base year.

[illegible]e Unthinkable – Taxation?

Å Why not? Remember Keynes ï ñThe only thing certain in life is Death and Taxation . .ò

Å What can Saudi Arabia do? Others are thinking and legislating about it in GCC (Kuwait, Bahrain, UAE and now under GCC umbrella a VAT?_ _ _).

Å Short Term Measures include:

i. Budget Adherence ï Letõs stick to what we said we will spend - - -

ii. Fees and Charges ï Expedient Measure. Donõt kill the goose laying the golden eggs - - -

iii. Better collections ï Zakat, Custom duties. WTO?

iv. Better Re-allocation of Expenditures ï Direct expenditures to most value-added, job generating sectors and reduction in wasteful subsidies.

Å Long Term Measures include:

i. Taxation ï Start with Value Added Tax. Equitable and immediate revenue generator

ii. Speed up Sale of Government Assets ï Pros and cons. Selling the family silver vs. generating market efficiency. Proceeds going where?

iii. Personal Income Tax ï Which margin to start? Where is poverty threshold level? Collection efficiency vs. cost. Will people accept?

Å Other Measures

i. Civil Service Reforms ï Wasteful current expenditure vs. long term capital investment

ii. Create a Revenue Stabilization Fund ï allocate certain oil revenue each year irrespective of oil prices. Strict drawdown criteria. (Norway, Kuwait)

Long Term Measures include:

iii. Regional Economic Empowerment ï Municipal elections. A Success. Go for economic empowerment and regional budget allocations - -

iv. International borrowing ï Why not? Borrow from a position of strength. Banks have short memories - - - -

v. Introduce Mini-Budgets ï Be pro-active on economic events/adjust forecasts (oil price scenarios).

FYING THE ECONOMY

ÅThere is urgent need to move away from oil revenue dependency before consuming nations reduce their own ñoil addictionò- - -

ÅOil revenue has been the fueling force for Saudi economic development, but the non-oil GDP has consistently grown.

ÅNow accounts for nearly 65% of GDP.

Table 4: Oil Revenue and Non-Oil GDP Diversification

	1970 – 1973	*1974 – 1978*	*1979 – 1981*	*1982 – 1985*	*1986 – 1991*	*1992 – 1996*	*1997 – 2001*	*2002-2004*
Oil Output (million barrels)	8.100	15.202	10.681	6.672	12.292	14.778	14.548	8.913
Oil Revenue (SR billion)	69.98	537.6	837.0	540.3	478.3	571.6	742.5	730.1
Non-oil GDP (SR billion)	25.1	147.6	224.3	607.8	789.3	808.4	1,522.1	1,397.0

Source: SAMA

DIE

ÅOne key aspect is Export diversification.

ÅTangible results achieved in this sector, but base of exports is still too narrow:

-Chemical products and by-products predominate,

-Manufacturing equipment and foodstuffs of Secondary importance.

ÅImplication: Can Saudi Arabia successfully diversify its exports or is doomed to one comparative-advantage sector ï Petrochemicals?

ÅIs this wrong? Implications for gas utilization ï into production domestically or LNG exports?

ÅWhat is the implication for future Saudi ñClear Energyò exports?

: Saudi Non-oil exports (SR billion)

Item	1984	1989	1995	1999	2002	2004
Foodstuff	0.166	1.442	1.589	1.768	1.845	3.516
Chemical products	1.460	5.616	10.166	9.189	13.681	18.672
Plastic products and construction material	0.029	4.160	5.455	3.529	6.115	12.599
Best metals	0.185	0.995	2.631	2.175	2.537	4.665
Electrical, Mechanical, Equipment	0.008	0.200	0.851	0.873	1.138	2.126
Other exports	0.079	0.692	1.866	1.953	2.907	6.222
Re-export	2.55	2.249	1.762	1.869	4.077	9.064
Total	4.432	15.454	24.320	21.356	32.300	56.864

Source: SAMA, 2003, Central Department of Statistics.

nging Alliances and Trading Partners

ÅImport diversification is also essential. Table 6 explores the changing patterns over the past 3 decades.

ÅThe rise of China is very obvious for both imports and exports.

ÅChina is now 5th largest trading partner and will soon overtake U.K.

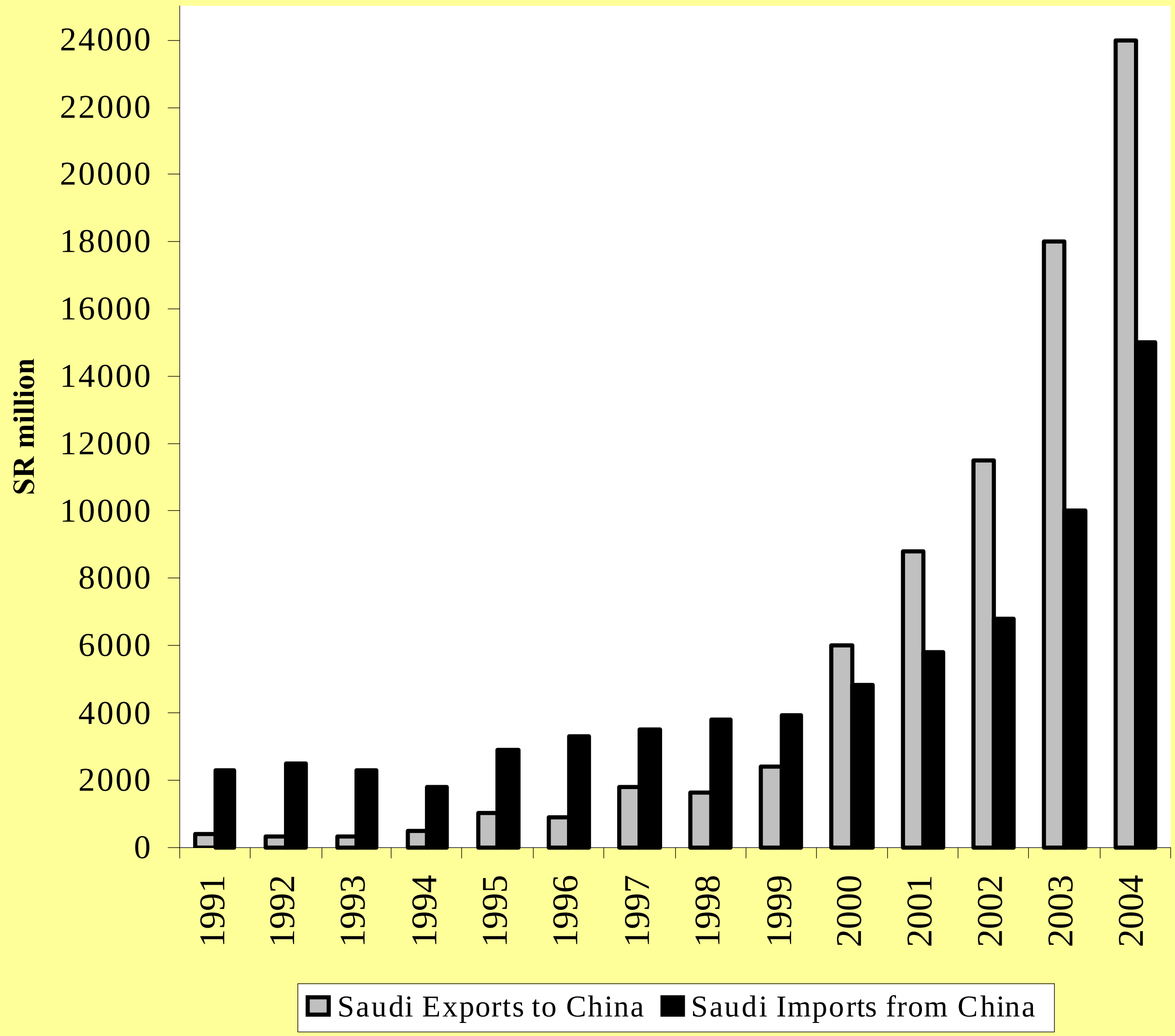
ÅIndia is currently 3.2% while Brazil is 1.8%. Both rising. Total GCC around 10%

udi imports by origin: Top five country positions by % of total import value 1972-2004

	1972		***1982***		**1998**		***2000***		**2004**	
	Country	*%*	*Country*	*%*	*Country*	*%*	*Country*	*%*	*Country*	*%*
1	USA	19.4	USA	20.1	USA	21.3	USA	16.3	USA	15.3
2	Japan	14.3	Japan	19.1	Japan	8.6	Japan	11.1	Japan	9.8
3	Lebanon	12.2	Germany	10.9	U.K	8.5	Germany	8.4	Germany	8.1
4	U.K	7.3	U.K	6.6	Germany	6.3	U.K	6.0	U.K	6.6
5	West Germany	6.2	Italy	6.0	China	3.2	China	5.3	China	5.7
Top 5 country % of total import value		59.4%		62.7%		47.9%		47.1%		45.5%

Source: *SAMA,* 2005.

Saudi-China Trade Trends 1991-2004



Source: Central Department of Statistics, SAMA

‚Where do we Diversify?

- The majority of Saudi commercial establishments are SMEÕs (Small and Medium Sized Enterprises).
- Majority employ less than 50 employees.
- Foreign participation (either joint-venture or 100% foreign owned) is predominantly in the lower level of employment category. Capital intensive nature of investments and service sector orientation.
- What is implication for Government expenditure patterns in future? Big or Small Companies?

…di Arabia: Establishments by classes of insured employment size and by nationality of ownership (2002)

Class of Insured Employment	*Saudi*	*Joint Ownership*	*Foreign Ownership*	*Total*
Less than 20	20,834	186	195	21,215
21-39	6,800	46	80	6,926
40-59	2,382	31	52	2,465
60-79	1,217	19	36	1,272
80-99	770	17	23	810
100-199	1,517	23	70	1,610
200-299	509	8	26	543
300-399	290	6	27	323
400-499	175	5	15	195
500 plus	526	17	28	571
Total	**35,020**	**358**	**552**	**35,930**

Source: CDS, Statistical Yearbook

Wealth Creation Vs. Financial Wealth Creation.

- Important to shift from a mentality of a flow of income wealth to a change in stock of wealth for future growth. Stock market bubble - - - -
- Who can generate this change?
- The Saudi Family businesses are one key area for:
  - Internal reorganization, efficiency and job creation.
  - IPO's
  - Listing, market depth (recent market falls – AlDrees stock)
  - Export diversification

di Family Businesses:

- A powerful positive and potentially negative economic force.
- Hold around SR 250 billion in domestic investment, with 200 family companies dominating commercial life.
- Majority of franchises and agencies owned by no more than 100 of the top Saudi companies.
- Time for change

mily businesses: changing management operating structures

Characteristic	Current Structure	New Structure
•**Organization**	•Pyramid, strict hierarchy	•Horizontal, delegation
•**Focus**	•Balance sheet growth, agencies and franchises	•Profitability, maximizing shareholder value, production
•**Ownership**	•Family, affiliated groups	•Publicly listed joint stocks
•**Financial structure**	•Internal raising of capital	•External funding, IPOs
•**Resources**	•Physical assets	•Human capital
•**Competition**	•Between family groups	•Between brands, services and products
•**Expansion**	•Using influence, family alliances and ñWastaò	•Productivity and achievement
•**Financials**	•Internal, annual, not audited	•Quarterly, audited
•**Leadership style**	•Top down, paternalistic, dogmatic	•Bottom up, inspirational
•**Worker**	•Mere employees	•Shareholders, participatory, critical
•**Job expectation**	•Look for security, obedience	•Personal growth, satisfaction.

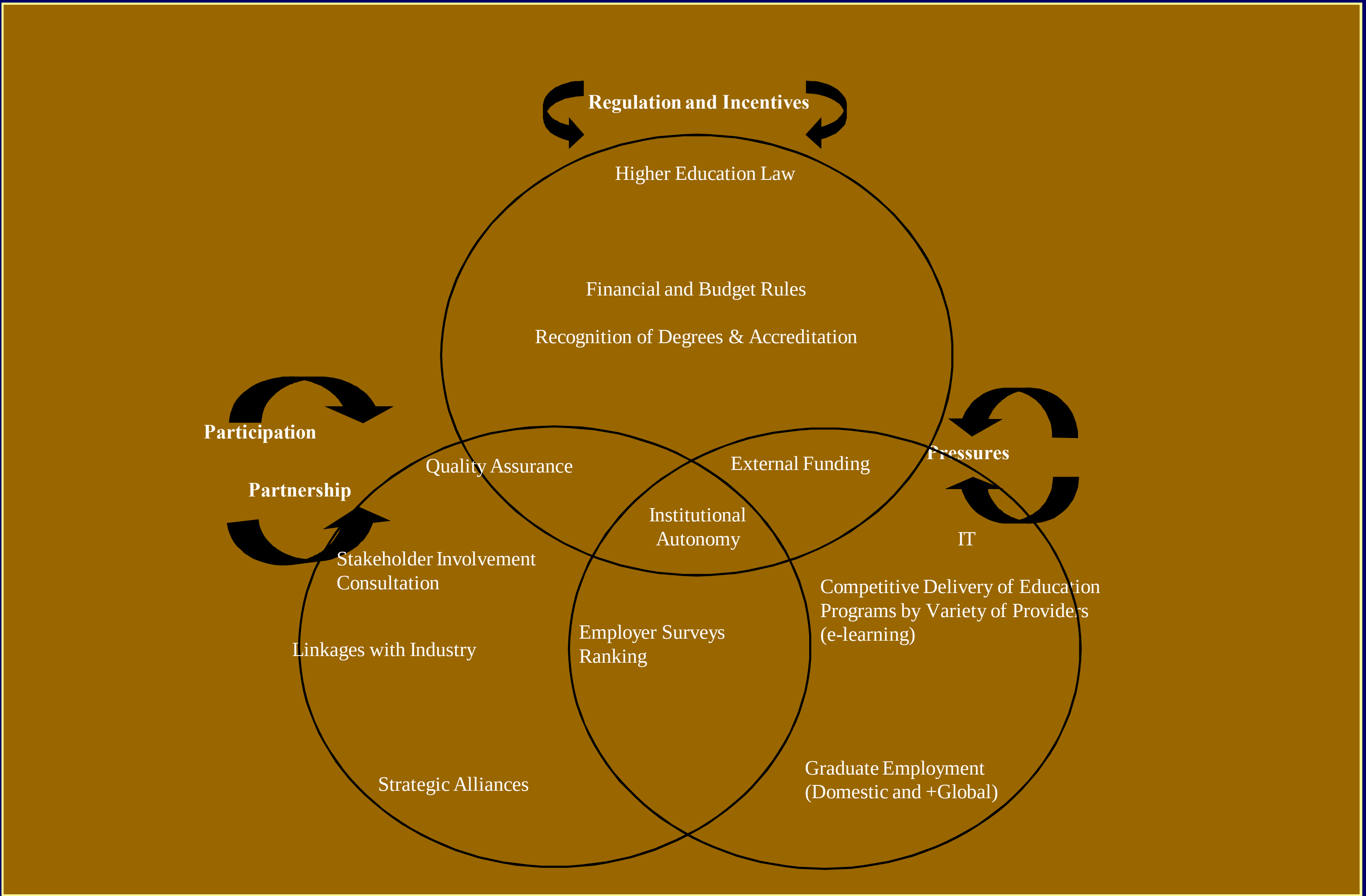
- How do we get the Family businesses to participate?
- A critical aspect is the Role and Effectiveness of the Saudi Capital Markets.
- Both aspects have been evolving as illustrated in the next slide, and now widened to included foreign resident participation.

changing face of the Saudi capital market

1970s	*1980s*	*1990s*	*2000 onwards*
• No disclosure	• Regulatory regimes improving	• Technology utilization	• Commercial paper and bonds
• External funding on selective basis	• External funding	• Specialized funds	• Family businesses going public
• Poor regulatory and legal structure	• Government soft loans	• Government debt increasing	• Mergers and acquisitions
• Commercial bank funding on secured basis	• Syndicated loans	• Islamic financing	• More disclosure and transparency
• Dominance of family companies	• Some disclosure available	• Foreign ownership on joint venture basis	• Securities and Exchange Commissions
		• Non-recourse finance	• Foreign Inward Investment
			• Privatization
			• IPOs
			• Securitization
			• Islamic financing

- What else needs to be done to effectively diversify the economy?
- Education, education and more education - -
- Are we really ready for the so-called ñknowledge-basedò economy and society?
- Issues ï the forces for change in Higher Education. Are we ready for the challenges?
- Issues ï Mismatch of labour skill needs and labour market entrants.

Forces for change in higher education



di Arabia: New entrants to the labour force by level of education (1990-2000)

Highest level of Education Completed	*1990 – 1995*				*1995 - 2000*			
	Male	*Female*	*Total*	*%*	*Male*	*Female*	*Total*	*%*
University (Total)	**38,300**	**30,300**	***68,600***	**30.5%**	**73,800**	**40,900**	***114,700***	**32.9%**
Engineering	4,700	0	*4,700*	2.0%	10,100	0	*10,100*	2.9%
Natural Sciences	4,100	4,700	*8,800*	3.9%	10,000	5,500	*15,500*	4.4%
Medical Sciences & Health	2,300	1,000	*3,300*	1.4%	5,500	2,600	*8,100*	2.3%
Statistics, Math, Computer Sciences	3,000	2,100	*5,100*	2.3%	12,700	4,100	*16,800*	4.8%
Economics and Business	3,700	1,600	*5,300*	2.4%	2,600	700	*3,300*	0.9%
Social Sciences	8,600	10,400	*19,000*	8.5%	9,000	12,800	*21,800*	6.3%
Teacher Education	5,400	5,200	*10,600*	4.7%	8,000	4,500	*12,500*	3.6%
Religious Study	6,500	5,300	*11,800*	5.3%	15,900	10,700	*26,600*	7.6%
Junior Colleges: Technical (Total)	**7,400**	**0**	***7,400***	**3.3%**	**12,800**	**0**	***12,800***	**3.7%**
Industrial	5,700	0	*0*		N/A			
Commercial	1,700	0	*0*		N/A			
Secondary School (Total)	**139,500**	**9,000**	***148,500***	**66.2%**	**209,600**	**11,500**	***221,100***	**63.4%**
General Education	103,100	7,500	*110,600*	49.1%	172,000	8,900	*180,900*	51.9%
Technical and Vocational	36,400	1,500	*37,900*	17.1%	37,600	2,600	*40,200*	11.6%
Total	**185,200**	**39,300**	***224,500***	**100%**	**296,200**	**52,400**	***348,600***	**100%**

Source: Ministry of Planning

zation

- Different things to different people
- Definitely brings about fundamental structural changes in the short run, with the hope that long term benefits outweigh such dislocations.
- A strategic choice for Saudi Arabia. Supreme Economic Council. Almost everything for sale from football clubs to the Railways.
- In reality it has been partial, or ñpaternalisticò capitalism privatization ï SABIC, STC, but bolder moves on the horizon eg. MAADEN in 2007.

Figure 4: Privatization scales

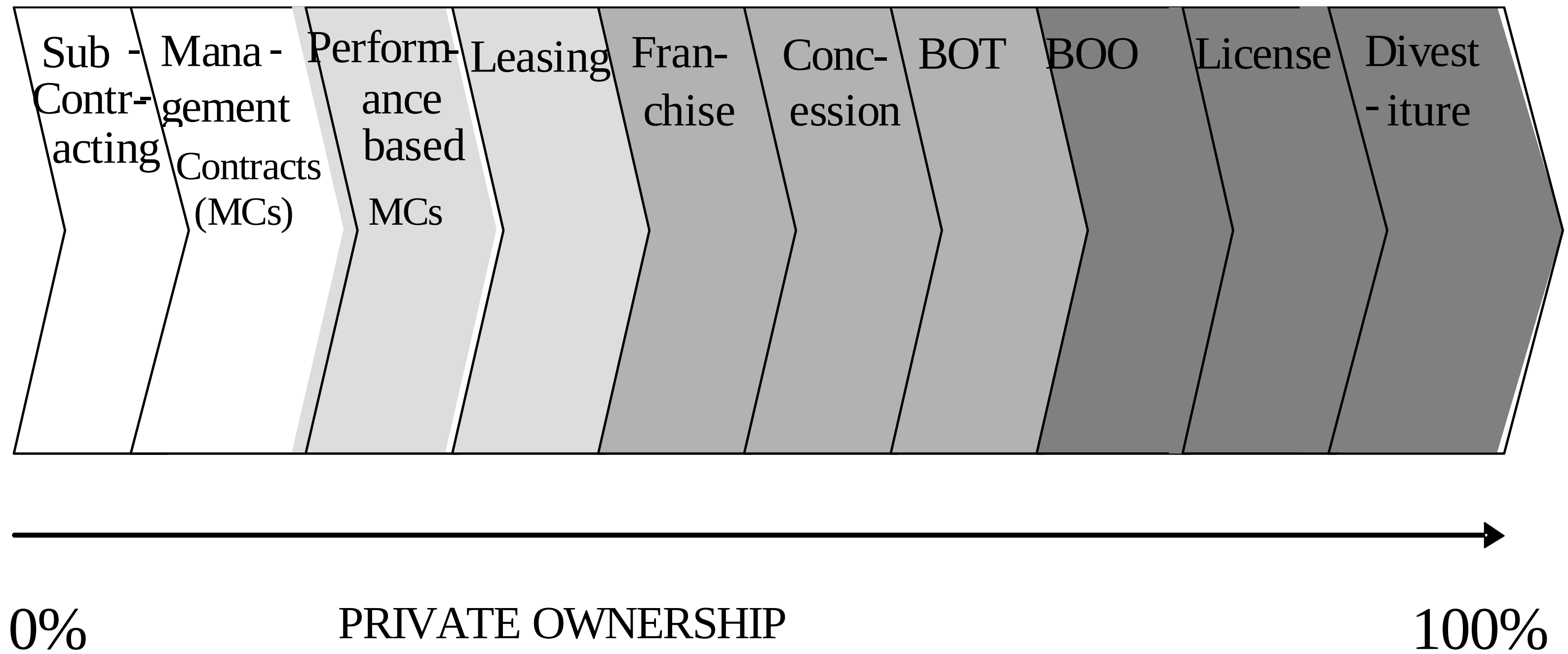


Table 11: Saudi privatization: possible obstacles

Obstacles	*Rationale*
1. Fair book value for public assets	• A wide gap could arise between the fair book value and the market price. There could be limited availability of information concerning government operations and future risk factors, thus affecting the valuation method.
2. Rigid pay structure	• Government employee pay scales are higher than in the private sector, and sometimes are not related to productivity. There is the problem of adjusting wages and reducing employment numbers, and of allowing the private sector to strike a balance between wages and productivity expectations.
3. Government Subsidies	• The removal of government subsidies on basic services such as utilities or healthcare could cause social problems. At the same time, artificially imposing low price levels will affect the most efficient allocation of private sector resources. Other forms of income support for those who are less well-off can be found.
4. Lack of Regulatory Framework	• The government needs to address this major concern to ensure consumer protection and a degree of competition after privatization.
5. Updating public sector accounting standards	• These need to be updated so as to allow prospective investors to evaluate the true worth of these privatized public corporations.
6. Financial Resources	• There is a lack of depth in current Capital Market structure that will make it more difficult to transfer public to private ownership. • Domestic banks have an aversion to long-term risk capital and there is an uncertain commercial /legal framework.
7. Employment	• Potential unemployment becomes an issue, as the government faces pressure to reduce current unemployment levels.

2: Consequences of privatization

Concept	*Measure*	*Countries*		*Source*	*Median 3 Yrs. before Sale*	*Median 3 Years After Sale*
Profitability	Net Income/ Sales	(IC)	=	MNR	5.5%	8.0%
		(DC)	=	BC	4.3%	11.0%
		(IC)	=	DM	14.0%	17.0%
Efficiency	Sales/number of employees*	(IC)	=	MNR	0.96*	1.06*
		(DC)	=	BC	0.92*	1.17*
		(IC)	=	DM	1.02*	1.23*
Investment	Capital Expenditure/ Sales	(IC)	=	MNR	12.0%	17.0%
		(DC)	=	BC	11.0%	24.0%
		(IC)	=	DM	18%	17.0%
Output	Sales adjusted by CPI	(IC)	=	MNR	0.90*	1.14*
		(DC)	=	BC	0.97*	1.22*
		(IC)	=	DM	0.93*	2.70*
Employment	Number of Employees	(IC)	=	MNR	40,850	43,200
		(DC)	=	BC	10,672	10,811
		(IC)	=	DM	22,941	22,136
Leverage	Debt/assets	(IC)	=	MNR	66%	64%
		(DC)	=	BC	55%	50%
		(IC)	=	DM	29%	23%
Dividends	Dividends/sales	(IC)	=	MNR	1.3%	3.0%
		(DC)	=	BC	2.8%	5.3%
		(IC)	=	DM	1.5%	4.0%

Notes: *Ratio in year of sale set to 1.00 to avoid large differences among industries

IC = Industrialized Countries, DC = Developing Countries.

MNR- Source: Megginson, Nash and Van Randerborgh (1994)

BC-- Source: Bourbaki and Cosset (1998)

DM- Source: D'Souza and Megginson (1999).

…bia and Globalization: What do Foreign Experts Think?

- Before assessing how Globalization/WTO is seen from Saudi Arabian perspective, what do Foreign Experts think?
- Has WTO membership been worthwhile or a long-term blunder?
- On January 2006, Saudi Arabiaôs WTO accession was discussed by a panel of experts on the Capital Hill, Washington. They were:
  - William Clatanoff, Former U.S. Trade Representative for Labor
  - Christopher Parlin, Loeffer Tuggey Pauerstein Rosenthal, Law Office (Representing Saudi Arabia).
  - Robert Jordan, Former U.S. Ambassador to Saudi Arabia
  - Charles Kestenbaum, Former Regional director, U.S. Dept. of Commerce.
  - Jean-Francois Seznac, Professor Middle East Institute, Columbia University
  - Chas Freeman ï President, Middle East Policy Council and Former U.S. Ambassador to Saudi Arabia.

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SPEAKERE	NEGATIVE COMMENTS	POSITIVE COMMENTS
FREEMAN (Moderator)	• Saudis divide world into 2 classes of people: ñUSò and ñemployeesò. Has to change. • Been able to make its own rules for investment and trade but no longer. • Agency agreements ï a ñprotection racketò from passive partners.	• WTO accession marks the end of an old era ñprogress without changeò. Now King Abdullahôs economic reform is pivotal. • Reforms currently underway cannot be retrenched, these will be a momentum of its own. • Saudi Arabia has record of stability and continuity of policies from one Monarch to another.
CLATANOFF (Ex U.S. Trade Rep.)	• Saudi Arabia was not serious before about WTO accession, talks started in 1993. Joining is a real commitment for change. • The old ñnegativeò list of prohibited investment activities was unacceptable. USA was the most difficult negotiating partner. • Employment issue is serious, can WTO ease this?	• WTO accession was in interest of Saudi Arabia. Non-oil trade was small (USA imported more from Hong Kong than all 24 members of the Arab League). • Agreements concluded on most issues which were obstacles before ï negative lists, agency agreements.

sis (Continued)

	IVE COMMENTS	POSITIVE COMMENTS
PARLIN (Saudi WTO Lawyer)		• Helping Saudi Arabia to become a ñmodelò WTO citizen. • The negotiations helped by a ñStrongò Saudi WTO Team (Yamani, Alami). • The Saudis liberalized their markets and restructured the legal regimes. Transformation occurred across the board. • Saudi Arabia recognized and accepted that they need to have a system ñthat others could understandò. • Saudi Arabia also accepted obligation of non-discrimination and similar national treatment.
JORDAN (Ex-U.S. Ambassador)	• Negotiations faced by Saudi uncertainties ï small staff, will power not there during 2002. • Disconnect between Saudi bureaucrats and then Crown Prince Abdullah who wanted to go forward faster. • Domestic Saudi resistance ï misperceptions about Islamic related issues ï Pork, alcohol etc. • International monitoring of Saudi compliance will be made.	• WTO accession was good for both U.S. and Saudi national interests. • Opportunity for Kingdom to reform their economy • Opportunity for Transparency, new areas Insurance, Finance, FDI. • Will require Saudis to be more competitive in the world.

sis (Continued)

SPEAKERE	NEGATIVE COMMENTS	POSITIVE COMMENTS
KESTENBAUM (ex Regional Director US Dept. of Commerce	• Saudis largely spoiled for last 4 decades in economic terms. Restricted markets. Protected markets. • Citigroup leaving Saudi as example of ñlack of controlò and not ñright decisionò from perspective of CitiGroup. • Saudi business ethics is ñtribalò. The ñGhazuò concept. ñWin-Loseò, not ñWin-winò in international trade. • ñFree marketò meant freely given by someone else, not by you ï education, health etc. • WTO rules will not be implemented the way everyone thinks. May be WTO was way of creating Saudi transition. Major fear is change without stability. • Saudi Arabia wants things to be stable. Things to be predictable. WTO will not offer this. • Saudization will not be helped by concentration on capital intensive petrochemical projects.	• Entitlement brings responsibility ï Saudi Society tries to take care of everybody.

sis (Continued)

	TIVE COMMENTS	POSITIVE COMMENTS
SEZNEC (Professor, Columbia Unviersity)	• Petrochemicals does not employ many people, but subsidiary industries could. • More transparency needed for commercial laws and Sharia'h rulings.	• Joining WTO will maximize Kingdomôs natural advantage ï cheapest feedstock for petrochemicals in the world. • Cost to Saudi is below $2 a barrel. • Saudi is 7th largest producer of petrochemicals in world. 46 million tonnes a year, with 10% from private sector companies not SABIC • World growth depends on petrochemical input component. China could not grow without it. U.S. trade could not grow without it. Saudi Arabia is a key world player. By 2015 Saudi will be the worldôs No. 1 petrochemical player. Today it is Germany ï thus EU obstacles. Not surprisingly no German-Saudi joint venture in this sector. • More foreign companies will come to Saudi to produce for the Chinese markets.

- What do <u>you</u> think?
- Where these <u>fair</u> comments?
- How do you feel about the WTO Accession?
- Let us analyze the WTO accession from our perspective - - - -

Globalization

WHY JOIN: BENEFITS TO SAUDI ARABIA

- Protect the Kingdom from discriminatory trade policies of other nations.
- Involve Saudi Arabia in settlement procedures to resolve trade disputes.
- KSA no longer subject to **anti-dumping** practices or counter-veiling duties except within WTO guidelines.
- Saudi exports to WTO members will be granted **Most Favored Nation** status.
- WTO membership will accelerate privatization, domestic economic reforms and make Saudi Arabia a more attractive destination for Foreign Direct Investment.
- WTO membership could also institute greater domestic efficiency and cost cutting measures in the economy.

quiet Voiced

- Some point out to the continuing disquiet amongst developing countries during WTO meetings (Cancun Seattle, Hong Kong).
- Globalization, trade libereralization and open markets will widen gap in income between the developed countries of the world.
- Some point out that WTO entry is sometimes a two-edged sword (e.g. Chinaôs entry and imposition of quotas on its exports by the EU, USA).).
- WTO accession requires that Saudi Arabia to remove protectionist barriers, place ceilings on tariffs, open further key service sectors to foreign participation and improve protection for Intellectual Property Rights.

TO FAMILY AT LAST:

What Saudi Arabia needs to do?

- Reducing import tariffs from around 15% to 7% levels, with further decreases in the future, with only a few exceptions.
- ñBindingò tariff levels on individual products to a guaranteed ceiling beyond which they cannot be increased.
- Phasing out government subsidies to the private sector and agriculture.
- Applying non-discriminatory treatment to the goods and services of other WTO members (Israel issue, secondary boycott removed).
- Allowing majority foreign ownership of investment projects.
- Treating foreign and local investors equally (equal tax treatment, removal of local sponsorship agents or ñwakeelsò, allowing foreigners to own real estate).
- Opening up the services and financial sectors.
- Guaranteeing ñpredictable and growingò access to the Kingdomôs financial markets.

ct of Globalization on Saudi Arabia Economy

Impact	Short-Term	Long Term Impact
Negative	Encouraging more imports to Saudi Arabia, with balance of payment implications	Questions about the ability of some Saudi industries to meet modernization challenges and adjustment costs
	Weaker local producers under Competition strain.	Potential structural unemployment.
	Govt. procurement policy, giving local Priority will be scrapped, making some Local firms unable to effectively compete against foreign competition	Exit of some industries due to reduction of subsidies, subsidized loans and tariff protection.
	Export sales may not go up due to quality considerations.	Foreign ownership of certain strategically deemed sectors (e.g. Communications)
	Growth in some sector could slow down, with unemployment consideration.	
	Implementation of international patent laws will have impact on certain factors, such as pharmaceuticals and chemicals.	
	Less efficient service providers in insurance, banking and telecommunications will be negatively affected by competition.	

Globalization on Saudi Arabia Economy (Continued,,,)

Impact	Short-Term	Long Term Impact
Positive	Lower priced imported inputs.	Shift from exporting primary products to exporting value-added industrial products.
	Higher multinational investment in local industry with implementation of international patent laws.	Local firms restructuring
		Formation of international strategic alliances with brand name manufacturers
		Development of specialized expertise in range of products.
		Higher multinational investment in local industry with implementation of international patent laws.
		Wider variety of technology transfers.

Sectoral Impact of WTO on Saudi Industries

- WTO accession could have profound impact on Saudi industries ï if they do not grasp both the opportunities and challenges from now.
- The recent Saudi stock market ñBullò run has made some balance sheets ñhealthierò through financial activities but not through trading activities. Eased need for long term restructuring.
- The forecasted impact results are mixed ï theoretically more losers than gainers, but the situation can still be managed if action is taken now.
- Let us examine the impact on the hydrocarbon sector and other major Saudi industries.

n Sector: Oil, Gas and Petrochemicals

- OIL
  - Oil is not excluded from WTO accession. Subject to Market Accession Agreements.
  - Historically outside, due to original GATT members excluding oil and oil products.
  - As practical matter, there are low or zero tariffs on crude oil imports.
  - Major Saudi concern is taxation on refined domestic oil products (*USA, EU).
  - Taxation however is imposed on all refiners ï national or foreign operating in that country. Thus ñnational treatmentò applies.
- GAS
  - National Gas (Ethane, Methane) sold by Saudi Aramco to consumers at a fixed price (SR 2.81 or ¢75) per million BTU. In USA $8.60 per million BTU.
  - Natural Gas not sold by KSA but used for domestic power generation, desalination, cement and petrochemical production.

n Sector: Oil, Gas and Petrochemicals (Continued)

- Pricing for NGL (Natural Gas Liquids) ï Propane, Butane ï has more complex international pricing formula under WTO.
- NGL is exported by KSA. Accusations from EU (Germany in particular) of ñDual pricingò of NGL.
- Domestic Saudi pricing-up to 30% of international pricing. Kingdom sells domestic NGL at a discount to international pricing for Naphtha.
- Domestic pricing however is adjusted downward according to following formula factors that helps KSA counter ñdual pricingò charges:
  - Cost saving in domestic NGL infrastructure
  - Cost saving in marketing
  - Long-term commercial domestic contracts
  - Commercial value of large volume domestic purchases.

n Sector: Oil, Gas and Petrochemicals (Continued)

- PETROCHEMICALS
  - Potentially a major winner for SABIC and Kingdom
  - Kingdomôs WTO accession made no commitment to change pricing of feedstock.
  - Under the Chemical Harmonization Agreement, KSA agreed to substantially lower all 64 chemicals exported by SABIC.
  - SABIC will retain substantial cost advantage and gain better market accession due to low tariffs, especially in Far East.
  - Kingdom will be helped by WTO dispute settlement procedure if tariffs imposed against it.
  - Within 5 years, KSA will not export NGL. All will be used domestically for petrochemical operations.

n Sector: Oil, Gas and Petrochemicals (Continued)

- IMPLICATIONS
  - WTO Agreements preserve Kingdomôs position on low cost feedstock.
  - Assurances given by KSA that domestic pricing is to be given to both wholly owned Saudi Companies as well as foreign Companies in petrochemical sectors.
  - KSA will become a magnet for foreign petrochemical manufacturers who will re-export to their own countries and to China through Saudi Arabia.
  - The Far East market will grow for KSA. Germany could put blocks on Saudi-China trade citing dumping

- What about the other major Saudi industries?
- A mixed bag indeed ï those most protected by tariffs and subsidized will be the most affected in the long-term. Employment implications.
- Could merge or downsize and outsource many of their operations to SMEôs to survive - - -
- Let us examine some key sectors

lization impact on selected Saudi industries

Sector	*Major features*	*Potential globalization impact*
Poultry	• SR 6 billion industry, with 2 companies having 50% of the market. 450 companies operating in the sector. • Subsidized (30% cash subsidy on poultry equipment, plus SR 160 per tone on imported feedstock). 20% custom duties.	• Industry will face major competitive forces after WTO entry with smaller companies at risk
Edible oils	• 9 operating units with capacity of around 360,000 tones. Current domestic demand 290,000 tones. Industry investment around SR 490 million.	• Fairly competitive industry with exports to Gulf countries, and some joint ventures abroad
Furniture	• SR5 billion market size with 65% imported. 125 large units operating, with another 7000 small units. • Low cost funding provided (50%) by SIDF. Tariffs set at 12% on imports plus 20% on protected items.	• Not a competitive industry as has no cost advantage. Raw material imported.
Refrigeration	• 24 local manufacturing units. Joint ventures exist with world brand names. Capital investment around SR900 million, employing around 5000. Production capacity 320,000 units p.a. • SIDF low cost funding (50%)	• Will face some competition after WTO entry but industry is mature with joint venture partners in-Kingdom and appropriate technology transfer having been made.
Paints	• 27 industrial units, capacity around 600,000 tones, domestic demand around 360,000 tones p.a. 8 units operate as joint ventures, total capital investment SR 850 million, employing around 3000.	• Competitive industry, mature and can cope with WTO entry due to rising world demand and paint prices.

Source: *Industry annual reports*

3: Globalization impact on selected Saudi industries (Continued)

Sector	*Major features*	*Potential globalization impact*
Steel and base metals	• Capital investment around SR 8 billion employing 31,000 in 357 projects in GCC. Saudi share 60% of GCC. Annual demand 2.5 million tones. 16 Saudi projects are FDI joint ventures • Protection exists for 116 items out of 740 lines, with 20% custom duty on imports.	• Export diversification taking place. Around 9,500 tones p.a. exported compared with domestic demand of 22,000 tones p.a. • Will face tough competition post WTO entry
Dairy	• SR 10 billion industry with domestic demand around 1.25 million tones p.a., 61 operating units, capital investment of SR 2.6 billion and employing 6,000 workers. 16 large units have capacity of 320,000 tones p.a. • Heavily subsidized up to 30% of total costs. SIDF loans.	• Will face major WTO competition with smaller operators at risk.
Cement	• 8 cement companies produce around 16 million tones p.a. Industry is mature and will organized domestically following restructuring.	• Export momentum continuing with around 18% for exports. Mostly regional markets leveraging on Saudi comparative advantages.

Source: *Industry annual reports*

3: Globalization impact on selected Saudi industries (Continued)

Sector	*Major features*	*Potential globalization impact*
Aluminum	• 26 units operating with capacity of 110,000 tones with 4 units producing 95,000 tones. Domestic consumption of around 120,000 tones. • No aluminum smelters exist in Saudi Arabia ï reliant on imported aluminum ingots • Shielded from competition ï 20% custom duties	• Will face competitive pressures post WTO accession, especially for smaller units.
Pharmaceuticals	• SR 6 billion market. Dominated by few companies, mostly with foreign joint ventures. 80% of consumption imported (40% government, 60% private sector)	• Very open to WTO trade. Liberalization and joint ventures will assure smooth transition.

Source: *Industry annual reports*..

TO THE FUTURE

- Yes, Light indeed at the end of the Tunnel - - -

Saudi Arabia and Economic Reforms

- Saudi economic reforms are gradually accelerating as part of WTO accession.
- These are of ñdual-trackò approachï both a planned and a free-market element.
- Saudi economic reform is more of a ñgradualistò strategy rather than a shock ï therapy strategy. (Eastern Europe).
- ñGradualismò is related to initial economic conditions and economic structures. For Saudi Arabia, there are 2 main conditions.
  - Saudi Arabia started its reforms before any of its State sectors were in decline (viz. Eastern Europe). As such heavy subsidies are not needed.
  - The state of economic reform and accompanying liberalization of State enterprises, in the presence of a large private-sector capital surplus ($ 800 Bn plus) generated domestic growth more rapid than at which subsidies were increasing.

- The political continuity of the government is another fovourable condition. The smooth transition of King Abdullah.
- Some of the changes under ñgradualismò were due less to planning (Saudi Arabia is a free-market economy), but more accurately characterized as adjustment to practical circumstances.
- The WTO accession and bi-lateral agreements are symptomatic of this approach.
- This gradualist approach however, is an ñEasy-to-Hardò reform sequence. Addresses easy problems first. A more radical approach would have been to maximize efficiency gains and minimize implementation cost of reforms.
- However, restructuring may be easier with the gradualist approach, as it minimizes political cost of reforms.

: Saudi Women and the National Economy

- More urgency on this matter. Government sympathetic as long as in conformity with Islamic principles.
- Substantial women's investment in domestic economy and impact:
  - 35% of bank accounts
  - Deposits SR 62 billion and growing
  - 20% corporate shares
  - 15% of private companies
  - 10% real estate
- Barriers remain: Social, institutional and legal but many barriers are coming down.

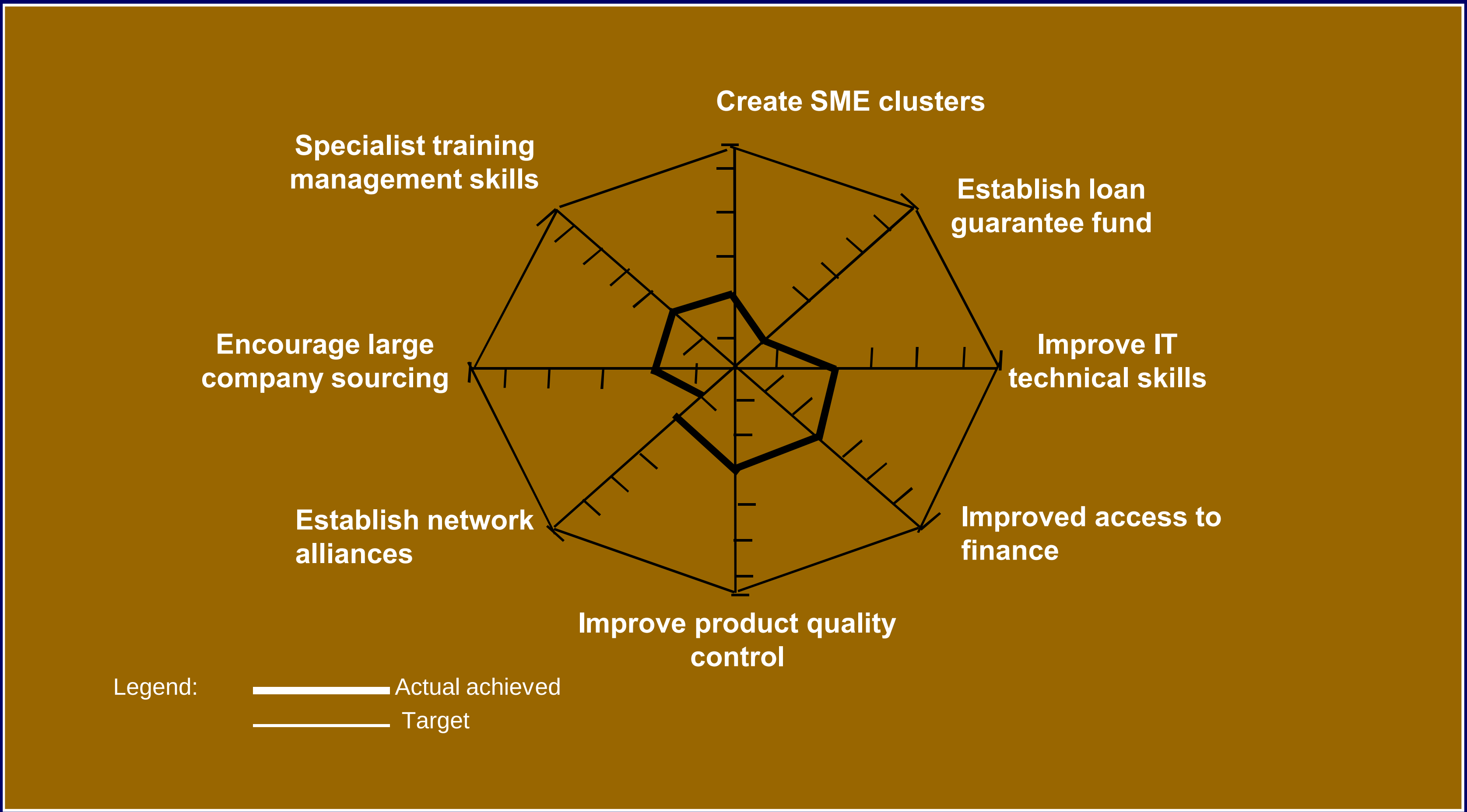
The SME Sector:

- Previously neglected, concentration on capital intensive, high technology industry.
- Limited financial resources ï state/private. The Government now addressing this.
- Limited managerial experience
- High foreign labor utilization

→ But they are powerful employment generators.

→ WTO uncertainties for big industries - SMEôs become attractive for Governments

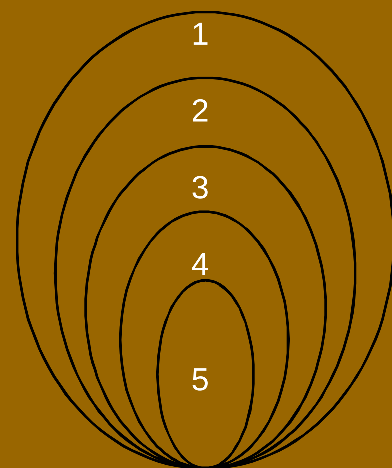
...ancement of SME survival and growth in Saudi Arabia



…ing with the Private Sector

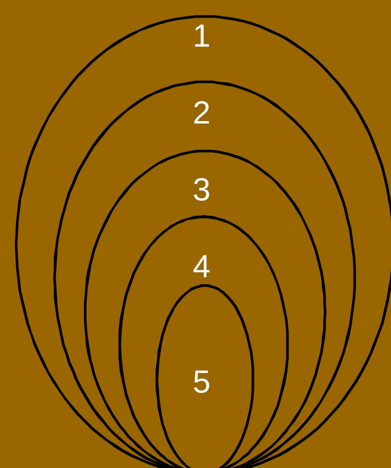
Figure 6: Saudi Arabia: Evolving government-private sector relationships

1970s-1980s



1. Government as planner
2. Government as financing entity
3. Government as buyer and seller
4. Government as regulator
5. Government as revenue collector

1990s-present



1. Government as regulator
2. Government as seller and buyer
3. Government as planner
4. Government as financing entity
5. Government as revenue collector

Private sector challenges and solutions

Challenges	*Opportunities and Solutions*
• **Promoting government-business dialogue and collaboration**	• The private sector has to engage the government in a dialogue on competitiveness and impediments to improving productivity
• **Internal business environment and international competitive comparisons**	• Up-to-date information on local and international market opportunities made available as well as comparing relative costs and efficiency with international standards
• **Expansion of the privatization policy**	• Private sector must engage in dialogue to ensure that transfer is done on a transparent basis with no ñhiddenò costs and commitment;; flexibility in hiring and firing
• **Paying attention to scientific research that might serve the production sector**	• Poor communication between the productive sectors and research centres must be overcome through R + D funding, and developing science park/incubator concepts
• **Increasing investment locally**	• Better coordination with SAGIA and Chambers of Commerce to create business and investor friendly environment; update and harmonize business regulations; create a demand driven economy
• **Reduce national unemployment**	• Short term ñfixò through expatriate labour reduction vs. long-term solution of employing productive Saudis; ensure that the market knows of the skill needs of the private sector

Conclusion and Challenges

- Managing expectations
- More effective dialogue between the government and private sector.
- Dealing with other communities; the external world.
- Employment generation that is meaningful.
- Education: quality not quantity.
- Stake in society ï municipal elections. Expanded role.
- Consensual change will be the means of change.

REFORMS BEGIN AT HOME AND STAY THERE