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Book Review

Mohamed A. Ramady (2010), *The Saudi Arabian Economy: Policies, Achievements, and Challenges*, Second Edition, Springer, Pp. xxii + 512. ISBN 978-1-4419-5986-7

Review by: Dr. Usamah A. Uthman
Associate professor of Economics
Department of Finance & Economics
King Fahd University of Petroleum & Minerals
Dhahran Saudi Arabia
E- mail: osama@kfupm.edu.sa
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The Saudi economy is one of the most important economies in the Arab and Muslim world. Its importance comes not only from the fact that Saudi Arabia acquires the largest oil reserves in the world, but also from the fact it is the largest Arab- Islamic economy, it is one of the G20 countries, in addition to its spiritual importance as the place for two of three Holy mosques for Muslims. The writing of a book about such economy is thus a worthy and very important exercise of scientific inquiry. Writing about such economy requires at least three distinctive qualities of the person(s) taking up that task. The writer must acquire a good grasp of economic theory, he must be following very closely the developments the Saudi economy has been going through over past years, and he must understand the special characteristics of the Saudi economy that makes it different from other economies. Such an understanding is necessary to explore and explain why and how the Saudi economy might be different from the typical western, textbook case. It is very unfortunate that none of these qualities is reflected in this book. Here are some observations:

- 1) The author does not specify his period of study of the Saudi economy.
- 2) The author does not explain how different his book is from other books in the same area, i.e. what is it that distinguishes his book from other similar books? In addition, why there is a second edition, aside from the fact there are additional data since the publication of the first. In other words, what sort of *qualitative* changes in the Saudi economy might have taken place to warrant another edition? There is a big difference, I believe, between a second edition and a second printing!
- 3) The book is replete with excessive, in many cases unnecessary, citations without any discussion on the part of the author. Thus, the book becomes mainly a work of compilations and citations from other sources. There are many, many statements in the book starting with the phrase "According to...." The author rarely discusses what the other sources say; he does not seem to take any position on these respects! Take for example his description of the Saudi economy as "a *rentier* economy"(Pp19, 45). There are four sources cited on this concept and a total of eight citations on the same page(19)! He

could have simply explained that a *rentier* entity (an economy, a firm, or a person) is one that makes income mainly from ownership, but not from work. It looks like that the author does not feel comfortable enough explaining the concept in his own words, or he is trying to impress the reader with the number of references he can cite! There are many other similar citations in the book; they cannot miss the reader's observation.

- 4) Many tables and figures in the book are not referenced. In addition, even for those that are referenced, in many cases the year and page number are not mentioned.

- 5) In some cases, the "discussion" around some figures and tables is totally unrelated to these figures and tables!! In other cases, they reflect poor understanding of basic economic concepts. Here are four examples. (a) **Figure 2.2 (p.28)** is supposed to show, in the author's opinion, "major Saudi business cycles". However, what the figure actually shows is real Saudi income in some spaced years. In basic macroeconomic theory, a cycle is identified by comparing *actual real GDP* (Gross Domestic Product) to *potential real GDP*. *The figure does not show the latter measure. Furthermore, the discussion is rather very brief about each claimed cycle. Neither there is a reference to an expanded discussion of Saudi business cycles in later chapters!* (b) **Another example is Figure 2.3 (p.30)**. It is adopted from Cleron 1978. The author claims (Pp29-31) that the figure shows "three important features of the Saudi Arabian economy". "First .. the crucial role played by the government sector" and "the importance of the oil and non-oil revenues.." The second feature, according to the author is "... the degree of interdependence with the rest of the world." "The third striking element is the relatively large portion of GDP that is paid for the use of the foreign – owned resources..." *Surprisingly, the figure does not show any of those features!!! It does not show anything about the relative importance of any sector in the economy.* What the figure actually shows is the flow of different forces that interact to determine the aggregate demand and aggregate supply in the Saudi economy. (c) **In table 3.1(p.45)** the author returns again to the idea of "a *rentier economy*" and how, in his opinion, the Saudi economy moved away from such economy over the years. However, all what the table shows are data about oil output and oil revenues. *It does not indicate anything whatsoever about any structural changes the Saudi economy might have gone through over the past decades!* (d) **Figure 3.5(p.55)** shows an indexed population, government revenues, and government expenditures growth rates. The author argues, "The figure illustrates the urgent need to diversify Saudi Arabia's sources of revenues in light of growing population needs." *However, that need could have been better explained by adding and comparing the above- mentioned three variables to the overall real economic growth rate, and the growth rates of the non- oil, and non-government sectors. The oil and government sectors are very large in the Saudi economy, but they do not comprise the whole economy.*

- 6) Some of the figures that seem to be the author's work are quite bizarre. For example, **Figure 4.4(p.85)** is supposed to show "SAMA's monetary policy framework", or how SAMA conducts monetary policy. However, the different "blocks" in the figure do not seem to lead one to another. The author should have simply started by indicating the policy instruments, leading to (affecting) the intermediate targets, which in turn affect the ultimate policy goals. Furthermore, while the author argues that the Final Goals of SAMA's monetary policy are price and financial stability, he does not explain why unemployment and GDP are not among those goals! Furthermore, if this is the case, what is the theoretical motivator for such a policy? Another example is **Figure 4.8(p.95)**. The figure is supposed to show the "domestic money creation process." It shows the different flows of dollars and Saudi riyals that affect the *Stock* of money supply in the Saudi economy. But the stock that is supposed to be affected by all of these flows is not shown in the figure!! In addition, the figure shows as if the impact of the domestic banking sector on the private sector is motivated by the government's accounts at SAMA. The question that arises is, suppose the Saudi economy is a closed one with no government intervention in the monetary process, wouldn't there be any money supply?! The fact to the matter is that there is a direct, independent link between banks and the private sector, in addition to the direct and indirect links to the government!
- 7) When he discusses monetary policy in Saudi Arabia, the author mentions five constraints that face SAMA in its conduct of monetary policy (P.83). He could have added a sixth one; SAMA is *not* an independent central bank. It is under full control of the government. However, in light of these constraints, and especially the "Centrality of SAMA's Exchange Rate Policy"(Pp.87-90), *he should have estimated a money supply rule* that reflects the role of the different forces that affect money supply in the Country. Theoretically, under a fixed exchange rate regime (in the Saudi case the riyal is fixed to the dollar), and assuming free mobility of capital (which is the official declared policy of the Saudi government) the monetary policy of the fixed currency is anchored by the reference currency. *The question is: in light of the fact that there are domestic and foreign forces affecting Saudi money supply, how dependent is Saudi monetary policy upon the American one?* The author argues, "interest rates play a subsidiary role, as they are predominately affected by US dollar interest rates." Suppose we grant the author his claim, does that mean that SAMA has been operating upon a money- supply rule (as opposed to an interest -rate rule?) Furthermore, the exchange rate of the Saudi riyal against the dollar has been fixed at SR3.75/\$, ever since 1986! Many things have been changing in and around the Country, but SAMA is insisting on a very rigid exchange rate regime! There are some economists, including those of SAMA and the IMF who claim that policy has served the Saudi economy well. Is that true?! Couldn't a more flexible policy have helped to reduce the twin deficits (the government budget deficit and the current account deficit) in the 1980's- 1990's?! Incidentally, the term "twin deficits" is never

mentioned in the book! Wasn't the real economic growth rate so low in the face of deteriorating oil income and government expenditures, coupled with a very rigid exchange rate and monetary policies? The centrality of the exchange rate policy invites serious investigation about its usefulness in the past, in the present and for the future.

- 8) In the chapter on the Saudi Capital Market (Chapter 6), the author goes at length in discussing historical developments, and legal issues. While a briefing on these issues may be useful, such length is not really a matter of economics science. More importantly, the author should have investigated how the change in the regulatory aspects of the market has affected the market performance, especially that he mentions, but does not apply, the different concepts of efficiency in the market. The Saudi stock market has suffered two big blows in the first decade of this century. The first one was in May 2004. It is not mentioned at all in the chapter! The second episode was the Big Stock Market Crash of February 2006. It is only mentioned very faintly twice or there times in the chapter, but no serious discussions are offered! Before and after the Big Crash of 2006, the performance of the Saudi stock market has been the heated talk of both national and international media at the time. It is unfortunate that changes in the regulations of the Capital Market came only after the big crash. It seemed to be too late. Many people lost their shirts forever, as the market never recovered to its pre- crash historical levels. *The author should have investigated why the crash took place, how has it affected (or not affected) the Saudi economy, and how and why it was different from other stock market crashes in other countries.*
- 9) The author does not seem to have captured some of the most important features of the Saudi economy. For example, his discussion of *Zakat* is rather very faint. He actually errs in characterizing what *Zakat* is. He describes it as an "Islamic levy on *total* assets (emphasis added)" (table 3.8, p.68.) Theoretically, *Zakat* is sort of an inventory tax. The modern proxy for *Zakat* base is the net working capital of the firm, not total assets. *Saudi Arabia is one of very few Muslim countries in the world that incorporates Zakat into the government official fiscal system.* The economics of *Zakat* could have been an area that the author investigated. *The improvement in the government's Zakat collection can be an important instrument to diversify government finances.* A few years ago, the Shura Council (Saudi Parliament) passed a resolution on collecting *Zakat* on real estate. *The volume of trade in real estate in Saudi Arabia is so enormous, that it really deserves an extensive study.*
- 10) Another neglected and related issue to the one discussed in point 9 above is land speculation. The continued appreciation in the prices of land has been crippling the Saudi economy. The author should have investigated the reasons why have that been the case for many years and how it has affected the economy's growth rate and the distribution of income. *The collection of Zakat on real estate in general and land*

acquisitions in particular can be an important tool to deal with the problem, in addition to improving government finances.

- 11) The treatment of subsidies in several places in the book is another deficiency. The Saudi economy is beset with subsidies, both for consumption and production purposes. Reported subsidies in government documents are most probably the direct ones. Indirect subsidies such as those in the areas of aviation, electricity, water, and petrochemicals are probably much more than the reported ones. The author should have investigated the size of these subsidies and; *how efficient and equitable* their use has been.
- 12) While the author declares on the Faculty Bulletin Board that Islamic finance is one of his interest areas, his coverage of the subject is rather shallow! This is another important area that the author could have cultivated to show how it has been affecting the Saudi economy, and how it could be improved. There is demand for Islamic finance in almost every corner of the world, even in non- Muslim countries!
- 13) Hajj (and Umra) to Mecca is very unique to Saudi Arabia. It is true that there are religious places in other countries around the world. But Mecca is the holiest place for about one quarter of the world population. The Saudi government has been pouring huge capital investments in the Holy places in Mecca and Medina. For all of these reasons, the economics of Hajj deserves a study in its own right, which the author neglects. *Islamic religious occasions follow a lunar calendar. The activities around the religious activities seem to be sort of a built- in stabilizers of the Saudi economy, should oil prices deteriorate.* In fact, the benefits of such activities may extend well beyond Saudi Arabia as Muslims from other countries pack to travel to the Holy Places.
- 14) The author says that he estimated the cost of unemployment in Saudi Arabia for the period 1993-2008 (Pp.389-390).He says that (The Saudi Arabian "natural rate of unemployment" (U*) is based on the author's own estimation,...). However, he does not explain how he made that estimate. In **table 12.15(P.390)**, in order for the author to calculate the GDP Gap, he subtracts his "estimate" of natural unemployment from what he reports as actual unemployment, and then "multiplying by a factor of 2 *as per Okun's Law (emphasis added)*" to estimate the GDP Gap!! Arthur Okun (1928-1980) studied the relationship between unemployment, and GDP for the US economy. He found that for every 2.5 percent increase in real GDP above the potential level, unemployment decreased by one percent, below the natural rate of unemployment (originally3:1). This became known as Okun's Law. It looks like that the author thinks that the ratio of one to two in Okun's "Law" is a universal one that applies every time and place!!!!!! He does not seem to realize that Okun's "law" is an empirical relationship (but not a law in the strict sense of the

word), which is subject to change once the underlying conditions that generated this ratio change. If Okun were resurrected from his grave, and he if he were to re- do his study about the American economy, he would probably not find it one to two!!! The novelty of Okun's study is not in the ratio he found out, but in studying the relationship between the two most important macroeconomic variables!

- 15) In several cases, the author tries to use some very obscure rules of thumb to substitute for formal scientific modeling and rigorous statistical analysis. In addition to above- mentioned examples, his attempt to forecast unemployment in Saudi Arabia is another one. In **table 12.11** he offers what he calls a forecast of "employment changes for Saudi males, for the period 2003-2013, based on the model of labor entrants developed in **Fig.12.8.**" However, the alleged model is nothing more than assuming certain percentages of school drop outs at different levels of schooling. He "forecasts" unemployment at 39.12 % in 2008, 45.39 % in 2011, and 48.23 % in 2013!!! (Pp.375-377).Furthermore he mentions that the official statistic for unemployment in 2008 was 9.8 %, justifying the huge discrepancy between his "forecast" and the official figure by "The truth of the matter is that there is no precise way to measure the rate of Saudi unemployment." (P.377). Granting him the claim that official data may not be "precise", does the inaccuracy reach as high as 300 % of a "reliable" forecast?! His "forecasting" model is never spelled out formally!

- 16) Except for the above- mentioned obscure relations, the author does not try to estimate any relation about the Saudi economy. For example, there is no estimate of a budget deficit rule, a money supply rule, an import demand function, or the relationship between the twin deficits.

- 17) A similar observation can be made about the chapter on "Saudi Arabia and WTO." For while the author cites at length government sources about sectoral obligations as a result of accessing the WTO, there is no quantification of costs and benefits in the aftermath of accession, neither at the microeconomic level nor at the macroeconomic one! For example, how would economic growth rate and unemployment going to be affected by accession to WTO?

- 18) In his discussion of the GCC monetary union (464-467), the author does not discuss how the international financial crisis, and especially the Euro Crisis, might affect the prospects of a GCC monetary union. In particular, what lessons are to be learned form the European experiment? The GCC countries are following the European footsteps in terms of the required "convergence criteria" to a monetary union. Are these criteria suitable anymore for the GCC's? Do they need additional ones? How could have the Dubai financial crisis of 2009 affected the GCC monetary Union had it been there before the crisis, and how might it affect the

prospects for a GCC monetary union in the future? Such questions are not taken up by the author.

19) The book is replete with journalism; paragraphs after paragraphs that are at best business- like reporting, but has no scientific value, and unnecessarily inflate the size of the book. See for example pp.22-23,25-27,43-49,57-61,75-81,111-123,140-141,145-147, 181-193,200-204, 210-213, 452-457, and many others. *In fact, there is so much of such business journalism, that one could conclude that it is the glaring aspect of the book!* While some of the reported things may have an informational value, it would have been sufficient to advise the reader about the relevant web sites on the internet.

20) A book that is intended to be offered to universities for possible adoption as a textbook, lacks several pedagogical aspects. There are no "Extensions, or Applications" in any chapter that shed light on any real – world cases, studies, or news that may be related to chapters' materials. Also, there are no end-of- chapter discussion questions, and no glossary at the end of the book!!!

Conclusion: I have not said in this report all what I could have about this book. Nevertheless, I find the book as an unfortunate, failed attempt to write about a very important subject. There are more citations than there are explanations, more compilations than there are own- contributions of the author's, more journalism than serious scientific analysis. Until a good, recent book is written, those in need are not without much better alternatives to this book. Among them are the annual reports of SAMA, reports by domestic and international banks, studies by the World Bank and the International Monetary Fund (IMF). Many of these studies are available on the internet, free of charge. Furthermore, such resources are more up-to-date in data and analysis than a book that may be revised once every four or five years!