The impact of Saudi Arabia's WTO accession on selected economic sectors and domestic economic reforms

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Abstract: Saudi Arabia's accession to the WTO will promote the competitive advantages of the local industries, creating both opportunities and threats for certain sectors. This situation will call for urgent economic reforms in order to succeed the challenges of the accession. This study will attempt to highlight the WTO accession consequences on the local economy and especially on some major industries.

Keywords: Saudi Arabia; WTO; globalisation; economic reforms.

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1 Introduction

Saudi Arabia has made a strategic decision to join the World Trade Organisation (WTO) to benefit from perceived globalisation and trade opportunities. WTO accession carries with it both opportunities and threats. The impact of global liaison reaches far beyond mere market openness and introduction of measures of international competition.

In essence, WTO agreements set to fundamentally transform existing domestic market structures into 'real' market systems and to establish Saudi Arabian global trade and production systems that comply with global 'rules of the game'. These potential changes have profound implications on government policies, enterprise reorganisation and transformation of the national economy.

This paper attempts to explore these various settings by examining Saudi Arabian decision to join the WTO and the verdict for developing countries in being inside or outside the WTO. We will next examine the impact of WTO accession by examining the implication for selected Saudi industries and services, specifically in the petrochemical, telecommunications and financial services sectors. All these are crucial in Saudi Arabia current economic structure, and WTO accession could have potential gross domestic product impact. The final section of the paper will deal with Saudi Arabia WTO accession and state economic reforms.

2 The new global economy: the process of globalisation

The process of globalisation can be generally considered as a dynamic process of increasing national integration with other countries, whether through convergence and expanding economic relationships, regardless of boundaries and institutions (Bonefeld and Holloway, 1996; Martin, 1999). Traditional trading theory states that trade without artificial barriers will always be beneficial to either trading parties and consequently the world as a whole and both consumption and production will rise. This gives relatively disadvantaged firms or countries the chance to enter the trading system (Porter, 1990).

The establishment of the WTO in 1995 introduced a new element besides traditional 'trade' in goods. Trade today has become more complicated and multi-faceted and includes virtually everything, especially services. The development of the internet and IT revolution has ensured that everything can be traded instantly – finance, services, information, technology and intellectual property – thus creating a truly globalised economy. Under such a system, national boundaries and sovereignties of nations come under threat, which necessitates that nations come together to create the necessary supranational organisation to govern this modern sophisticated trading system. The WTO has evolved into such a supranational trade organisation.

Recent rapid developments in information technology have enabled national organisations to diversify their products and markets with the result that information externalities allow the globalisation movement to go beyond national boundaries towards an integrated 'seamless' global trade system, and the growth of 'homeless' monies that move electronically around the world at instant speed (Martin, 1999). The globalisation of finance has been one of the most dramatic changes occurring since the establishment of the WTO, and in effect it has rendered national boundaries largely meaningless (Ohmae, 1990, 1995; O'Brien, 1992; Kobrin, 1997; Budd, 1999).

3 Saudi Arabia and the WTO

There is no doubt that Saudi Arabia is one of the largest markets in the world and the largest in the Arab world for many manufactured and service goods. To this end, the kingdom of Saudi Arabia has deemed a strategic decision to join the WTO to enable the country to obtain added benefits of globalisation. The working perceived party on the accession of Saudi Arabia was established on July 21, 1993 (WTO website). Saudi Arabia gained formal accession in October 2005, especially following the successful bilateral agreements with the USA in May 2005. Along with Russia and the Ukraine, Saudi Arabia had remained the largest economy in the world and the only country of the Gulf Cooperation Council (GCC) that is not a member of the 147 state-trade bodies.

The process of accession and membership to the WTO, will, in principle, provide Saudi Arabia with many benefits. Firstly, it will protect the Kingdom from discriminatory trade policies of other nations by fostering greater interdependence and by involving the use of settlement procedures to resolve trade disputes with other nations. Secondly, Saudi Arabia will no longer be subjected to anti-dumping practices or countervailing duties except within the framework of WTO guidelines. Instead, Saudi exports to WTO members will give the kingdom Most Favoured Nation (MFN) status. Thirdly, the mere process of WTO membership will help accelerate privatisation, domestic economic reforms and make Saudi Arabia a more attractive destination for Foreign Direct Investments. Finally, the accession to WTO could institute greater domestic efficiency and cost-cutting measures in the Saudi economy.

There are concerns amongst Saudi businesses and in some intellectual circles about globalisation and its impact on the Saudi economy (Salah, 2002). They point to the worldwide disquiet that is widely expressed during WTO meetings in world capitals. Some seem to share in the belief that trade liberalisation and open markets will widen the gap in income between the developed countries of the world. Saudi businessmen assert that the consequences of joining will be harmful to a large sector of Saudi industry. The reasons for their fear are not entirely erroneous.

Globalisation means taking some fundamental decisions about changes that are necessary in order to be parts of this so-called 'global family'. If Saudi Arabia does enter the WTO, it should, in theory, help increase Saudi Arabia's volume of trade, but it also presents several negotiating, cultural/religious and economic problems. WTO accession will require that Saudi Arabia remove protectionist barriers, place ceilings on tariffs, open further key service sectors to foreign participation (such as banking, finance and the upstream oil sector), and improve protection for intellectual property rights. It will have to endeavour to build an open, transparent and rules-based regime with tribunals on trade disputes and new legislation on technical trade barriers, customs evaluation and food health regulation. Additionally, WTO calls for tariff limitation, several sectoral initiatives (including an Information Technology Agreement), a government procurement agreement and agreements on pharmaceuticals, medical and construction equipment, in addition to all publishing services.

Membership will entitle Saudi Arabia to all the benefits that have been exchanged among WTO members, especially protecting Saudi Arabia from arbitrary exclusion of its exports to other WTO members; petrochemicals are a key example. However, it is not clear so far from the talks whether the Kingdom will join WTO on stricter 'richest country' terms or on the looser rules and exemptions normally granted to developing nations.

In accession talks, the WTO requested that the Kingdom introduce further liberalisation reforms in the following key areas (Ramady, 2005):

- reducing import tariffs from around 15–7%, with further decreases in the future, with a few exception
- 'Binding' 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
- enforcing intellectual property rights
- guaranteeing 'predictable and growing access' to the Kingdom's markets
- allowing majority foreign ownership of investment projects
- treating foreign and local investors equally, which means equal tax treatment, removing the requirement that trade must be conducted through commercial or sponsorship agents (Wakeels) and allowing foreigners to own real estate
- opening up service sectors such as banking, legal, insurance and capital markets to greater foreign participation.

In turn, the Saudi government has indicated that it will take a phased approach to the following issues:

- establishing new trademark and intellectual property laws
- removing technical barriers to trade by easing travel visa requirements
- signing the Information Technology Agreement and phasing in tariff-free trade in information technology equipment
- phasing in the Basic Telecommunications Agreement to allow competition in telecommunications services
- changing competition laws to provide anti-trust protection and consumer protection in accordance with WTO rules (Salah, 2002).

Saudi Arabia has also insisted that its cultural and religious requirements be respected by its trading partners, particularly with regard to the treatment of goods such as pork and alcohol, the import and sale of which are forbidden in Saudi Arabia. The impact of globalisation can be viewed from short- and long-term perspectives. Table 1 sets out a brief summary of the potential impact of globalisation on the Saudi economy, based on field research for different Saudi business sectors (Ramady, 2005).

Table 1 Impact of globalisation on Saudi Arabia economy

Impact	*Short-term impact*	*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 modernisation 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 owing to reduction of subsidies, subsidised loans and tariff protection
	Export sales may not go up owing to quality considerations	Foreign ownership of certain strategically deemed sectors (e.g., Communications)
	Growth in some sectors could slow down, with unemployment consideration	
	Implementation of international patent laws will have impact on certain sectors such as pharmaceuticals and chemicals	
	Less-efficient service providers in insurance, banking and telecommunications will be negatively affected by competition	
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 specialised expertise in range of products
		Higher multinational investment in local industry with implementation of international patent laws
		Wider variety of technology transfers

Source: Ramady (2005, p.340)

Table 1 indicates a mixed score sheet of positives and negatives. As far as the private sector was concerned, their major worries centred on the loss of export markets. Of even greater significance was the loss of the lucrative and discriminatory government contracts, for which only Saudi companies could bid, resulting in the institutionalisation of local industrial inefficiencies. Some Saudi service and manufacturing enterprises were designed and set up to function in a secure environment protected by high tariffs and monopoly agency agreements.

Having to operate under WTO rules might put them out of business, as opening up the economy to foreign multinationals and imports will threaten profit margins and the monopoly of commercial agencies. The insistence of the industrialised countries on fully implementing these changes was one of the prime causes for the failure of the Cancun 2003 WTO talks.

The threats arise from the inability or unwillingness of major Saudi industries to adapt themselves to the new economic challenges and international competition that will be faced. Dependency on state subsidies and protectionist tariffs might induce a sense of economic security in the short term. In the long term, WTO accession will ensure that only economically, managerially and financially efficient companies are the ones most likely to survive and grow in the era of globalisation.

4 Impact of accession on selected Saudi industries

As discussed above, Saudi Arabia WTO accession could have a profound impact on the nation's various industrial sectors, especially on key hi-tech industries that had been cushioned from international competition until now, but which are expected to face competition from overseas counterparts. The petrochemical, telecommunications and the finance services sectors are examined in this section to assess how they can effectively withstand WTO accession.

4.1 Petrochemical industry

Saudi Arabia holds the right of trade and exploration for upstream petroleum production, although joint ventures with foreign companies in gas exploration have been initiated under the Great Gas Initiative Program between Saudi Aramco and foreign companies during 2003–2004. The petrochemical downstream industry is dominated by the majority-owned Saudi Arabian Basic Industries (SABIC), but SABIC also operates joint ventures with foreign-owned companies. WTO accession will provide golden opportunities to open up this sector further to restructure and upgrade itself through further cooperation and joint ventures with world-leading companies.

The Saudi petrochemical industry is generally competitive in terms of tariffs applied by leading industrialised countries that are already members of WTO. Table 2 sets out petrochemical tariffs applied by the European Union (EU) as well as Saudi Arabia in 2005. The table indicates that Saudi Arabia will not suffer unduly owing to WTO entry, but there could be some market loss for those products where the Saudi tariff rates are higher than EU tariffs. However, Saudi Arabia will have several years of grace period to restructure those petrochemical industries that currently enjoy subsidies and high-tariff protection. Saudi Arabia has committed to lower its tariffs and open its markets to imported petrochemical products with tariffs on polyethylene, polypropylene and polystyrene reduced from 12% to 8% within an interim period ending in 2008, followed by a second interim period ending in 2010 by which time the tariffs will be reduced to 6.5%. At the same time the EU will be reducing its tariffs on the same range of products to 6.5% levels. As a result it might be difficult in the long run for high-cost producers in the EU and elsewhere to meet the lower market prices caused by tariff reductions.

Table 2 Petrochemical tariffs: Saudi and EU comparison (2005)

	EU	*Saudi Arabia*
Ethylene bi glycol	5.5	6.5
Ethylene	0.0	2.0
Ethylene glycol	5.5	2.0
Melamine	6.5	6.5
Methylterene buthyletherene (MBTBE)	5.5	2.5
Methanol	5.5	2.5
Propylene	0.0	5.5
Styrene	0.0	0.0
Polyethylene LDPE-LLDPE-HDPE	12.5	12.0
Polystrene and polyvinylchloride (PVC)	12.5	12.0

Source: Gulf Organization for Industrial Consulting (2002) and ITC (2005)

According to SABIC, membership of the WTO can be good to the company (SABIC, 2004) resulting in two benefits. First, it will protect SABIC against anti-dumping measures to which non-members have no redress, making life much easier when dealing with WTO members. Second, it will ease the flow of goods and services between countries, making SABIC even more global in nature. However, SABIC is taking no chances even after WTO entry and has embarked on an energetic policy of establishing joint venture operations in major petrochemical-consuming, developed and developing countries. In the long run, this market diversification will be of more importance to SABIC than the impact of tariff reduction from current protected economies such as the EU for several reasons, namely that nearly 50% of the Saudi petrochemical exports are to non-tariff-protected Asian markets and that the competitiveness of the Saudi petrochemical industry depends primarily on competitive priced feedstock, which represents as much as 60% of the integrated cost in the industry. As long as Saudi Arabia can maintain this comparative cost advantage, then the petrochemical industry in that country will continue to benefit from entry to new markets through WTO accession.

4.2 Telecommunications

Saudi Arabia is widely recognised as the largest telecommunications market in the Middle East region, with an estimated 30% growth/annum. Foreign investors have recently been allowed entry into the lucrative telecommunications and internet service sectors in Saudi Arabia when Saudi Telecommunications Corporation (STC) lost its monopoly in 2004 to Ittihad Ettisalat (Mobily), a United Arab Emirates-based telecommunications player in the mobile telephone market. WTO accession envisages more foreign players in this sector. In June 15, 2005, in less than one month from launching its services (May 25, 2005), Mobily reaches 260,000 subscribers, 110% more than the targeted number (Arab News, 2005). The company's aim is to register some 7 million customers within the next four years. Moreover, Mobily is anticipating creating some 5,000 jobs over the next four years. From its side, STC took some steps to promote its competitive advantages by introducing many services (e.g., Qitaf Points;

Data and WAP; Conference Call; Fax Service; JawalNet, etc. …) and reducing tariffs on others (e.g., Aljawal Business Discounts).

Table 3 illustrates the competitive trends for the two current players in the Saudi market showing difference in pricing since competition was allowed for foreign players. Foreign company entry will accentuate this trend putting STC under pressure.

Table 3 Telecommunication competitive trends: STC and Mobily (June 2005) (SR)

	STC		
Competitive factor	*Before mobily launch*	*After mobily launch*	*Mobily*
Prepaid			
Set-up fee	100	50	150
Initial credit	200	200	150
Calling rates	1.2	0.85 (On-net)	0.79 (1st and 2nd minute)
		1 (Off-net)	0.69 (3rd minute onwards)
Regular subscription			
Set-up fee	100	50	45
Monthly fee			
	60	Jawal 35: 35	Mobily 25: 40
		Jawal 45: 45	Mobily 100: 65
Calling rates	*On-net*	*On-net*	*On-net*
	0.5 (Peak)	Jawal 35: 0.45	Mobily 25: 0.43
	0.4 (Off-peak)	Jawal 45: 0.35	Mobily 100: 0.43
	Off-net	*Off-net*	*Off-net*
	4.7 (Thuraya)	Jawal 35: 0.50	Mobily 25: 0.37
	1.5 (Gold star)	Jawal 45: 0.50	Mobily 100: 0.37
International (*basic rates*)	*Selected countries*	*Selected countries*	*Selected countries*
	Bahrain: 2.2	Bahrain: 2	Bahrain: 1.9
	Egypt: 3.4	Egypt: 2.8	Egypt: 2.7
	Lebanon: 3.6	Lebanon: 3	Lebanon: 2.7
	UK: 3.8	UK: 3.8	UK: 3.5
	US: 3	US: 2.5	US: 2.5

Source: STC (2004, 2005) and Mobily (2005)

Table 3 indicates the extent of mobile telephone price competition following the entry of a new player in the Saudi market. The reason is simple as in the rest of the world; telecommunications demand in the Gulf is exploding. In 1994, the Saudi Telecommunications Company installed 80,000 lines/year. In 2005 it installed 80,000/month. It will only be a matter of time before landline competition will be allowed. According to press reports, the latest Saudi offer in WTO negotiations with the USA includes a sale of a 20–40% share in Saudi Telecommunications Company to a single foreign partner.

4.3 Financial sectors

Foreign wholly owned banks were allowed entry to Saudi Arabia during 2003 and 2004, reversing an earlier trend to 'Saudize' the foreign bank branches operating in the Kingdom (Ramady, 2005). Foreign branches are expected to use their larger mother companies' capital base to go after 'big-ticket' project financing and investment advisory services, while Saudi banks see WTO accession as an opportunity to capitalise on their local client knowledge and niche expertise in retail, consumer and Islamic financing products. It is in the Saudi insurance sector that the most impact will be felt with foreign companies aggressively pushing for a larger market share in a yet relatively untapped personal, corporate and institutional insurance sector.

Table 4 indicates the potential growth of the insurance sector following the granting of new licences to foreign companies by the Saudi Arabian Monetary Agency (SAMA), which acts as the supervisory and regulatory authority for this sector. Market estimates believe that insurance premiums will rise significantly owing to government regulations specifying compulsory insurance on drivers as well as medical insurance for private sector employees, both Saudis and expatriates. The latter are estimated to be 6 million, which will give a big boost to the insurance market.

Table 4 Insurance market evolutions

	June 2005	*Future*
Number of companies	14	22
Market volume (estimation)	SR 4 Billion	SR 15 Billion (2009)
% GDP	Less than 1%	3–5%

Source: Arab News (2005)

5 Saudi Arabia paths to economic reform

Saudi economic reform measures are gradually accelerating as part of WTO accession. The transition strategy undertaken by Saudi Arabia may seem to be of a 'dual track' reform path, because there seems to be both a planned and a free market element involved. As such, Saudi economic reform can be termed to be more in tune with a 'gradualist' strategy rather than a 'shock therapy' strategy, which seemed to have been the hallmark adopted by the Eastern European and former Soviet Union Economies. 'Gradualism' is related to initial economic conditions and economic structures. For Saudi Arabia there are two main conditions that seem to permit an incrementalist reform approach to be successful.

- Saudi Arabia started its reforming before any of its state sectors were in decline, so that heavy subsidies were not needed.
- The start of the economic reform and accompanying liberalisation of state enterprises in the presence of a large private sector capital surplus generated domestic growth rapid enough to outpace the speed at which subsidies to state enterprises were increasing.

- Another favourable condition is the political continuity of the government and its ability to control the process of growth. Some of the changes under gradualism were owing to less planning, but more accurately characterised as adjustment to practical circumstances such as bilateral trade agreements and domestic economic restructuring owing to erratic oil revenues over the pats two decades (Wilson, 1997).

However, a gradualist approach is in actuality an 'easy-to-hard' reform sequence. It addresses the easy problems first and leaves the hard ones until later. A radical approach would be to maximise efficiency gains and minimise implementation cost of reforms. However, restructuring may be easier with the gradualist approach as it minimises the political costs of reform. This has been the hallmark of Saudi economic reform to date.

6 Conclusions

The process of globalisation and the IT revolution of recent years have stimulated profound changes in the global trading landscape. This paper argues that Saudi Arabia international ties, through the entry to WTO, will have a tremendous impact on Saudi Arabia enterprise reorganisation and restructuring the national economy as well as its key production and service sectors. WTO accession, could, if managed effectively, be considered to be critically important step to revitalise the Saudi private sector on sounder footing. The integration of the Saudi market system, currently dominated by the government sector, with a more open global system means that international forces such as foreign capital inflow, management experiences, competition mechanisms and instant information flows will increasingly play an important role in shaping Saudi domestic market and trade systems. This will allow the domestic market to be more transparent and accountable.

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