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State Business Relations and the New Economic Agenda in Saudi Arabia

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INTRODUCTION

Large fiscal deficits brought about by the precipitous decline in oil prices in late 2014 and long-standing challenges with youth unemployment have been two of the dominant underlying themes driving economic policy in Saudi Arabia in recent years. These challenges, though not unique in the region, loom particularly large when compared to some of the kingdom's "Super Rentier" neighbors[1] and have engendered a sense of urgency at the policymaking level.

These trends have also formed the backdrop against which significant domestic political change has taken place, with new leadership that is attempting to undertake a series of transformational economic reform programs, most notably the Vision 2030 plan and the more granular National Transformation Program.

These changes taken together, however, have precipitated fundamental transformations in the social contract between the state and the various constituencies in the kingdom, with the changing relationship between the state and the religious establishment garnering plenty of attention in international media. Perhaps more interestingly for scholars of resource-rich countries in particular, however, have been attempts to transform the relationship between the state and public sector employees, and between the state and business.

This paper will focus on the changing dynamics of state-business relations in particular, and try to understand what challenges this might pose to the broader reform agenda. By exploring the dual pressures being exerted on the state by high levels of unemployment on the one hand, and large fiscal deficits on the other, the seemingly conflicting policy outcomes can be identified, examined, and contextualized.

PRESSURES FROM WITHIN AND WITHOUT

The wide range of policy proposals that have emerged as part of the Vision initiative, and other initiatives that predate it, can be divided along a host of different lines. I've found it most useful to start with the underlying pressures confronting the state, and draw a line to the policy initiatives that have come about as a result. Two pressures quickly emerge as the dominant forces shaping economic policy since 2014.

The first, global in scope and more recent, is the 2014 decline in oil prices, which has brought about fiscal deficits of a larger and more troubling scale than those seen in the past. There are, of course, varying levels of urgency across the Gulf Cooperation Council (GCC) states. Saudi Arabia sits somewhere in the middle in terms of urgency, with the "super rentier" states (Kuwait, the UAE, and Qatar) on the less urgent side, and Bahrain and Oman on the other. However, it could well be

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argued that as the dominant state in the region, the stakes are actually much higher in the case of Saudi Arabia. In the years immediately following the sharp decline in oil prices, the more short-term alarmist viewpoints—warning of impending fiscal insolvency—have largely been dismissed, but there is little doubt that the long-term fiscal prospects of the business-as-usual case are bleak.

The second pressure, which separates the kingdom from its GCC peers, emerges as a result of the rapidly changing demographic trends that are bringing large numbers of young people into the labor market. This pressure is not qualitatively, but quantitatively unique. The sheer number of young people seeking to enter the labor market every year, combined with the state's dwindling resources, is what sets it apart from its neighbors. The statistic of 70% of the population being under the age of 30 is often cited, and a very large proportion of them are unemployed, potentially as high as 34%.

It is the confluence of these two pressures that is alarming. Individually, these pressures are not uncommon, and the size of the current public sector wage bill is a testament to how issues of bulging demography and unemployment were addressed in years past, namely by distributing patronage through public sector employment.

In the current climate, these two pressures have brought about the rise of two seemingly inconsistent economic agendas, with the fiscal situation prompting a neoliberal economic response from the state, and the unemployment pressures and recessionary climate prompting a more statist and nationalist response. This will certainly not be a strange trade-off to policymakers and scholars of other regions, who have confronted similar challenges in the last few years.

These trends have formed the backdrop against which significant political change in the kingdom has also taken place, with new leadership that is attempting to meet these challenges, and balance some of these interests. This change, both structural (the centralization of power in the royal court) and personal in nature, represents an additional variable, though it is beyond the scope of this paper.

KEY ELEMENTS OF THE LIBERAL ECONOMIC AGENDA

As a response to large fiscal deficits and unsustainable spending, the state has undertaken a host of new economic liberalization policies with the aim of promoting private sector growth and foreign direct investment (FDI), and in doing so, alleviating the pressure on the Saudi state as the economy's main source of employment. This kind of reform is not new in principle. For several years, the World Bank's Ease of Doing Business Index was an important key performance indicator (KPI) for Saudi policymakers aiming to attract foreign investors in the kingdom. Led by the Saudi Arabian General Investment Authority (SAGIA), the entity tasked with attracting FDI into the kingdom, the state made strides in improving its performance in many of these indicators, leading to a rise to 12th place in the global index by 2011, before the World Bank changed its metrics. After the World Bank changes, the country has ranked in the 90s in recent years. In many ways, this reflects broader concerns investors continue to have about the Saudi economy, often relating to deeper structural challenges in the judicial system or political risk. And while many of these structural issues remain, the new set of liberalization policies being implemented cuts deeper than attempts in years past.

This part of the reform package has been met with a positive response from the global investment community, eager to gain greater access to what is seen as a largely untapped emerging market economy. The privatization element of the agenda in particular, perhaps the most recognizable of the Vision 2030 economic initiatives, has attracted wide interest from investors, but has also raised fundamental questions about the role and responsibilities of the state toward public sector employees, for example.

More broadly, the following set of policies that have been, or are in the process of being implemented emerge from this economic agenda:

- The liberalization of equity markets to promote investment and allow greater foreign ownership in a wider range of industries. The new bankruptcy law is an example of a reform in this area.
- The privatization agenda, which outlines plans to offload a range of valuable state assets (to include elements of health care, education, airports, and most notably 5% of the state owned oil company Aramco).
- Energy subsidy reform, which has seen fuel and electricity prices rise in recent months as part of a medium-term plan to reach global market prices for utilities.
- Large global investment opportunities like NEOM and the Red Sea Project.
- The rollout of a variety of excise or sin taxes, and VAT.
- Consolidation of state assets under the Public Investment Fund (PIF), and the pursuit of a more aggressive investment strategy and dynamic asset allocation, typified by the Vision Fund/SoftBank investment.
- Cuts in capital expenditure by the state, particularly in education and infrastructure, and attempts at reductions in current expenditure, such as the public sector benefits and pay freezes.
- The issuance of local and international bonds, totaling $40 billion in the last 18 months.

Although these reforms have been well received by international investors, the response from the local private sector has not been as positive. They too are undoubtedly interested in the privatization opportunities, but energy subsidy reform, along with a host of new taxes and levies, has significantly increased the price of doing business in the kingdom, particularly for energy-intensive industries (albeit from a low base). This has come at a time when the state has curtailed capital expenditures, which in years past have been the single most important factor underlying private sector growth, while also opening the door to greater foreign competition. More generally, these reforms have translated into a concerted effort to rewrite the structural elements of the social contract between the local private sector and the state, upending the status quo and causing significant disruption to the way the local private sector has conducted business in the kingdom in decades past.

KEY ELEMENTS OF THE STATIST/ SAUDIZATION AGENDA

As a result of the strong demographic pressures in the labor market, the state has also simultaneously continued to maintain a series of policies that have been grouped in this brief under the umbrella of "Saudization," a term often more narrowly used for policies aiming to increase the share of Saudis employed in the private sector. These policies have a common statist and often nationalist theme and, in contrast to the liberalization agenda, such policies have always been viewed with skepticism from the private sector.

The centerpiece of this agenda is the ongoing effort of the Ministry of Labor and Social Development to increase the number of Saudis working in the private sector, predominantly through the Nitaqat and Taqat programs,[2] but more broadly through a host of policies including:

- Levies on foreign labor and their dependents, leading to a large exodus of migrant workers, both documented and undocumented, likely exceeding 1 million departees by 2018.
- An increase in the scope and pace of Saudization efforts, through the Taqat program from the Human Resource Development Fund (HRDF), and the continual expansion of the Nitaqat program.
- Decreasing the ease of access to visas for skilled and semi-skilled foreign labor.
- A growth in the scope and scale of state-owned enterprises, or state-led initiatives, most prominently through the PIF and its "Saudi Sector Development" pool in, among other sectors, agriculture (the

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Saudi Fisheries project), energy (Softbank Solar), and entertainment (AMC).

It is clear that these sets of policies, unlike those grouped under the liberal umbrella, do not share as clear a link to an ideological paradigm—much in the same way the historical growth of the welfare state in the kingdom was not necessarily ideological, but rather, constituted a type of rentier statecraft aimed at distributing patronage and wealth in the cultural and social context of midcentury Arabia.

AREAS WHERE THE AGENDAS COLLIDE

These two sets of policy agendas, clearly stemming from different pressures and seemingly emerging from competing ideological camps, continue to clash in certain areas, often resulting in a somewhat confusing institutional landscape for multinational investors as well as local businesses small and large.

As an example, a typical way in which this clash may manifest was illustrated in January 2018 when, five days after sharp increases in utility prices and the introduction of the VAT, the government announced a series of cash bonuses to government employees and members of the armed services. The selective mitigation of the new economic conditions for public sector employees reinforced the split with private sector employees. But in a deeper sense, the move revealed that even in an era of rapid change and economic liberalization, the knee-jerk reaction of the state is to revert to entrenched modes of patronage, which is arguably endemic to its structure.

The response from the local private sector has not been as positive.

The following section will highlight three typical ways in which, in a broad sense, these agendas clash, though a more exhaustive analysis could be the focus of further research.

An often cited example of this kind of clash comes from the skills mismatch of young Saudis entering the labor market from the public education system. Though the education budget in the kingdom continues to be one of the largest as a percentage of GDP comparing to the OECD, recent years have seen the budget shrink, even while other types of spending recovered in 2017-2018 from the mild austerity of the previous two years. Additionally, educational outcomes in STEM related subjects in particular are still lackluster, and there continues to be a pronounced skill mismatch among university graduates entering the labor market. These challenges have formed the backdrop against which additional pressure has been placed on the private sector to replace foreign skilled workers with Saudi workers. The complexity of new regulatory regimes—from the financial sector, to energy, and consulting—have also increased licensing requirements on companies operating in these spaces, often specifically calling for a certain number of employees with certain qualifications.

Another kind of clash, which has manifested in a variety of industries and on a number of scales, emerges from the growth of state-owned enterprises or initiatives, and the perception that they are crowding out investment from the local private sector and small- and medium-size enterprises (SMEs) in particular. An eagerness by the state to spur rapid growth in certain strategic industries that have been neglected in the past has led to state-owned enterprises (SOEs) directly tackling these opportunities, often with foreign joint venture partners. In many instances, this type of SOE growth seems to stem from challenges in implementing structural changes to create healthy and more organic investment ecosystems in the past, but also from an eagerness within the state to create "national champions" capable of using the Saudi market as a jumping board to compete globally. The examples of the PIF-AMC partnership or the PIF-Softbank partnership to develop utility-scale solar energy in the kingdom fit neatly into this category.

The final and perhaps most serious clash emerges from the state's attempt to encourage the growth of private sector employment while maintaining high levels of public sector pay, benefits, and bonuses, which continue to have a profound distorting effect on the labor market. This feature of public sector employment, often described in the literature as endemic to the structure of the state, along with the private sector's long-held reliance on cheap foreign labor, form arguably the most significant challenges to the economic reform agenda.

The state's continued efforts to curtail the private sector's reliance on cheap foreign labor—while maintaining most elements of public sector compensation—is telling, and reflects the rigidity of the state's social contract with public sector employees, and simultaneously the malleability and weakness of the social contract with the local private sector and business elite.

CONCLUSION

The pressures that produce these two different economic agendas are not unique to Saudi Arabia. However, in the absence of strong institutions capable of balancing competing interests in a clear and predictable way, and communicating the reasoning behind policy and agenda choices, the local private sector may find the policy mix that emerges from this melting pot difficult to digest. Other recent developments outside of the realm of economic policy have also likely contributed to a tentative approach by much of the local private sector. Further research is needed on the nature of these clashes, the patterns that exist between them, and the impact on actual private sector participation in various elements of the reform agenda.

ENDNOTES

1. This term refers to the three wealthiest Gulf Cooperation Council states in GDP per capita terms: Qatar, the UAE, and Kuwait.

2. Nitaqat and Taqat are programs that require and incentivize the private sector to localize its labor forces according to a complex set of rules and regulations.

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