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BLURRY VISION: INSTITUTIONAL IMPEDIMENTS TO REFORM IN SAUDI ARABIA

by

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In April 2016, the Saudi Arabian government announced Vision 2030, a highly ambitious reform program designed to move the country away from its reliance on oil revenues and to liberalize its conservative social dynamics. Despite the monarchy's autocratic power, the kingdom has largely failed to employ citizens in the private sector, diversify its industries beyond hydrocarbon-related activity, and privatize the key drivers of its economy since adopting these goals in 1970. The majority of the population is under the age of 30, unemployment is high, and international energy markets are changing, so the country's leadership needs to make changes that provide opportunity for the people and make the economy more sustainable.

This thesis examines why the Kingdom of Saudi Arabia struggles to implement economic and social reform. By analyzing interconnected political, economic, and social causes that manifest in the structure of the state and society, the resource curse, and market inefficiencies, we show that the ultimate barrier to reform is the kingdom's political dynamics. Without improvements to governance and modifications to the country's patronage policies, economic change will be limited at best. Elites' preferences for blocking political reform has hampered achievement of economic goals and will continue to prove problematic if not rescinded.

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BLURRY VISION: INSTITUTIONAL IMPEDIMENTS TO REFORM IN SAUDI ARABIA

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LIST OF ACRONYMS AND ABBREVIATIONS

FBP	Fiscal Balance Program
FDI	foreign direct investment
GDP	gross domestic product
IEA	International Energy Agency
IFI	international financial institution
IPO	initial public offering
ISI	import substitution industrialization
KA-CARE	King Abdullah City for Atomic and Renewable Energy
KAEC	King Abdullah Economic City
KAFD	King Abdullah Financial District
KAUST	King Abdullah University of Science and Technology
KSA	Kingdom of Saudi Arabia
MbS	Mohammad bin Salman
MbN	Mohammad bin Nayef
MENA	Middle East and North Africa
NTP	National Transformation Program
PIF	Public Investment Fund
PPP	public private partnership
PPP	purchasing power parity
RCJY	Royal Commission for Jubail and Yanbu
RPLA	resource poor labor abundant
RRLA	resource rich labor abundant
RRLP	resource rich labor poor
SABIC	Saudi Basic Industries Corporation
SAGIA	Saudi Arabian General Investment Authority
SAMA	Saudi Arabian Monetary Agency
SME	Small and Medium Enterprises
SOE	Sate Owned Enterprise
TFP	total factor productivity

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I. INTRODUCTION

A. OVERVIEW

The Kingdom of Saudi Arabia (KSA) is at an economic and social crossroads. In April 2016, the government announced Saudi Vision 2030, a reform plan that addresses growing modern challenges that threaten the sustainability of the entrenched societal model. Oil discovered in 1938 eventually fueled state-led development that shaped the rentier state of today where the government, clergy, and population agree to coexist under a symbiotic social contract.[1] In this system, the people render political acquiescence to the monarchy in exchange for a subsidized life, while the clerics support the House of Saud for the price of religious semi-autonomy. Traditionally, oil revenues funded public sector jobs, provided free education, reduced the cost of living, etc. Despite repeated attempts to modify this dynamic, the country's economic and social models remain much the same today as they did four decades ago. Yet changes in global energy markets and expansion of the Saudi population indicate that this way of life may soon end. The new vision is essentially a way to modify the social contract while preserving royal power. As Thomas Lippman notes, "Saudi Arabia is conducting a giant, long-running laboratory experiment on itself to determine whether it can modernize its economy, its style of living, and its relations with the rest of the world without abandoning its cherished traditions."[2]

The Saudi Arabia that the world knows today began to take shape in the 1950s, while organized attempts to diversify the government's revenue sources and the composition of the country's industries began with the First Five-Year Development Plan in 1970.[3] The government has implemented iterative plans every five years since then, shifting focus on physical infrastructure, human development, regulations, etc., as needed. The country's leadership placed greater emphasis on diversification and

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[1] Steffen Hertog, *Princes, Brokers, and Bureaucrats: Oil and the State in Saudi Arabia* (Ithaca: Cornell University Press, 2010), 13–15.

[2] Thomas Lippman, *Saudi Arabia on the Edge* (Washington, DC: Potomac Books, 2012), 4.

[3] Tim Niblock, *Saudi Arabia: Power, Legitimacy, and Survival* (London: Routledge, 2006), 50.

privatization of the economy after periods of prolonged budget deficits in the 1980s and 1990s.[4] Despite significant achievements in building the modern state in just over a half century, the record of implementing desired reforms is mixed at best, as Greg Gause notes that "'Doing very little' is the bane of all Saudi reform efforts."[5]

This thesis' first main finding is that the structure of the government prevents policy implementation. Coordination between ministries is poor since most are headed by a prince or technocrat who runs his organization like a "fiefdom," resulting in a highly centralized "hub-and-spoke" bureaucratic structure where the country's key leaders sit at the intersection of the government's independent entities.[6] Additionally, most ministries are divided into three tiers, so ideas that develop at the national level do not fully reach all of the state's employees, particularly the most junior personnel who carry out the day to day operations of the government. In addition to facing this constraint, the state must convince the conservative population that social liberalization is a positive change while convincing young people and the business elite alike that economic modernization is in their best interest. Another key finding is that KSA does not fit all aspects of the description of the classic rentier state and that it partially suffers the effects of the resource curse. Oil wealth made the country better off in many ways, but it also restricts policy choices, leads to macroeconomic underperformance, and distorts the labor market. Some government efforts have reduced, but not eradicated, the impact of the curse. Finally, the competitiveness of Saudi workers and companies is insufficient to create a knowledge economy, but these measures do not inhibit economic reform on their own because they are a side effect of government policy and the oil curse.

The central finding of this thesis is that patronage is the crucial impediment for the Saudi state to overcome in implementing Vision 2030 successfully. Patronage plays a central role in shaping the Saudi political system and economy and in creating opposition

[4] Tim Niblock and Monica Malik, *The Political Economy of Saudi Arabia* (New York: Routledge, 2007), 57–65, 104–08.

[5] Gregory Gause, "Saudi Arabia at a Crossroads? Notes from a Recent Visit" Strategic *Insights* 3, no. 2 (2011), https://calhoun.nps.edu/bitstream/handle/10945/11180/gauseFeb04.pdf?sequence=1&isAllowed=y.

[6] Hertog, *Princes, Brokers, and Bureaucrats,* 13, 17, 31.

to political change. The implications are more far reaching than simply creating rent seeking attitudes. Patronage shapes the structure of the government, influences education and employment choices, defines the relationship between the people and the state, and limits the monarchy's autonomy. Governance attitudes and outcomes also factor in patronage considerations, which in turn shape how the government manages the country's oil wealth to meet society's needs.

This thesis examines the strengths and weaknesses of the political economy of Saudi Arabia as they relate to the state's capacity to engage in economic and social reform. Foreign policy is discussed briefly due to its economic importance regarding KSA's position as the world's leading crude oil exporter and the birthplace of Islam. The paper's scope excludes direct discussion of many topics commonly featured in Western literature and media, such as opinions of the country's human rights record, the history of Wahhabism and its connection to Salafi-inspired terrorism, or the struggle against Iran for leadership in the Islamic world, to include implications regarding the wars in Syria and Yemen.

B. VISION 2030: TACKLING KSA'S CHALLENGES

Vision 2030 is essentially a revolution disguised as a bold reform measure. Most of the targets center on social constructs and economic policies and practices that support a volatile and unsustainable growth model. Crown Prince Mohammad bin Salman (MbS) is the plan's patron and orchestrator, and the scale and timelines of changes he is seeking are vast and aggressive. Western press has covered his political career's rapid rise since his father became king in 2015.[7] After MbS took charge of the ministries responsible for the economy and defense as Deputy Crown Prince, which entailed announcing Vision 2030 and running the war in Yemen, the king promoted him to Crown Prince and thus heir apparent in June 2017.[8]

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[7] Ben Hubbard, "Saudi King Rewrites Succession, Replacing Heir with Son, 31," *New York Times,* June 21, 2017, https://www.nytimes.com/.

[8] Ibid.

King Salman's decision to remove Crown Prince Mohammad bin Nayef (MbN) increases the likelihood that the country's new economic vision will receive the political support that it needs from the monarchy over the next decade. Western speculation questioned the viability of the program if MbN ascended the throne, since a large portion of MbS' political clout appears tied to the success of these economic reforms and to the stagnant Yemen war.[9] Skeptics may view Vision 2030 as a power grab, but the amount of resources devoted to the plan in the face of pressures to uphold the status quo point to a genuine desire to reinvent the country by revolutionizing how the kingdom conducts business and what it means to be Saudi.

1. Purpose

Vision 2030 subdivides into three themes that shape its intended areas of focus: "A vibrant society, a thriving economy and an ambitious nation."[10] Economic change cannot occur in isolation, so modifications in governance and the role of population must also take place. Addressing challenges in each area is necessary to achieve the overall vision. The project seeks to revitalize the long-standing policies of diversification away from oil, privatization of productive industries, and employment of more citizens in the private sector via "Saudization."[11] The plan also introduces new approaches to augment the primary economic and social policies.

a. Why Now

Besides a lackluster history of reform, several other factors pushed the monarchy to seek change. Economic stressors are forcing change upon the Saudi system, with immediate pressure coming from decreased oil prices that began in 2014. The Saudi Arabian Monetary Agency (SAMA), the country's central bank, issued $17.5 billion in

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[9] Simon Henderson, "Saudi Arabia's Vision 2030, One Year On," The Washington Institute for Near East Policy, April 24, 2017, http://www.washingtoninstitute.org/policy-analysis/view/saudi-arabias-vision-2030-one-year-on.

[10] "Vision 2030," Kingdom of Saudi Arabia, 13, http://vision2030.gov.sa/en.

[11] Ibid., 36–46.

bonds in 2016 in order to support the government's budget.[12] Besides the dollar figure, this event was notable since it was the first time that SAMA listed Saudi treasury bonds internationally.[13] The prospects of oil prices returning to pre-2014 levels are unlikely due to changes in global production, particularly the emergence of shale in the United States and Canada.

A second reason to implement the new vision now is to harness the energy of the population. King Salman appointed nine grandsons and great-grandsons of King Abdulaziz to deputy governor positions in June 2017.[14] He also named Abdulaziz bin Saud, another of King Abdulaziz's great grandsons, to Interior Minister.[15] This reflects the change where young people are becoming more significant actors in Saudi Arabian politics, in addition to comprising the bulk of the workforce. It is crucially important for the monarchy to facilitate an environment where the next generation can thrive. Approximately half of the population is under the age of 30.[16] The youth bulge may have factored into King Salman's decision to promote MbS to Crown Prince; placing the first grandson of King Abdulaziz in line for the throne can facilitate aligning the monarchy's perspective with its population.

Finally, time is of the essence. Reforms need to shift economic growth to privately owned non-oil sources before the government is unable to sustain the population.[17] Unemployment is high, particularly among young people. Additional

[12] Jeffrey P. Snider, "What Happens Overseas Doesn't Necessarily Stay Overseas," Seeking Alpha, November 17, 2016, https://seekingalpha.com/article/4024181-happens-overseas-necessarily-stay-overseas; "Ministry of Finance Appoints Mr. Alsayari to Lead the Debt Management Office," Ministry of Finance, February 23, 2017, https://www.mof.gov.sa/en/MediaCenter/news/Pages/news_23022017.aspx.

[13] Davide Barbuscia and Sudip Roy, "Saudi Arabia Sets Record with Mammoth $17.5 Billion Bond Issue," Reuters, October 19, 2016, http://www.reuters.com/article/us-saudi-bonds-idUSKCN12J1E7.

[14] Karen Elliot House, "Saudi Arabia in Transition: From Defense to Offense, But How to Score?" Belfer Center for Science and International Affairs, July 2017, 6–7, http://www.belfercenter.org/sites/default/files/files/publication/SA%20Transition%20-%20web.pdf.

[15] "PROFILE: New Saudi Interior Minister Prince Abdulaziz bin Saud bin Nayef," Al Arabiya, June 21, 2017, https://english.alarabiya.net/en/features/2017/06/21/PROFILE-The-new-Saudi-Interior-Minister.html.

[16] "The World Factbook: Saudi Arabia," Central Intelligence Agency, Accessed August 22, 2017, https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html.

[17] Luay Al-Khatteeb, "Saudi Arabia's economic time bomb," Brookings Institution, December 30, 2015, https://www.brookings.edu/opinions/saudi-arabias-economic-time-bomb/.

concerns lie in the future demand for Saudi oil, whether from stronger crude competition, the rise of renewables, or global climate change policy.[18] Environmental degradation is changing the physical landscape and will have future political implications, which will impact a variety of policies.[19] Projections for physical habitability in the Gulf are depressing, with temperature increases and water security being primary concerns. Life in KSA, and the region at large, is on track to be possible only indoors via air-conditioning by the end of the century.[20]

b. Achieving the Goals

Vision 2030 is quite ambitious, as detailed in Figure 1, but its benchmarks must be aggressive if some degree of structural change is to occur over the next 13 years. Various ministers attest that their superiors robustly monitor their progress and that rapid change is the expected standard.[21] In addition to renewed attempts at diversification, privatization, and Saudization, the vision seeks to implement several novel initiatives designed to stimulate interest in the country, better manage resources, and improve the quality of life for both citizens and foreigners. Examples include developing a tourism industry outside of religious pilgrimage, integrating solar power into the electrical grid, and developing a cultural ministry that creates venues for entertainment.[22] The new approaches reflect that young Saudis are interested in a lifestyle that is more liberal and modern compared to their parents' and grandparents' generations.

The vision's policy implementation mechanisms take shape in 13 programs: Government Restructuring, Strategic Directions, Fiscal Balance, Project Management, Regulations Review, Performance Measurement, Saudi Aramco Strategic Transformation,

[18] Emran El-Badawi, "When the Largest Oil Exporter Quits The Game," *Forbes*, October 10, 2016, http://www.forbes.com/sites/uhenergy/2016/10/10/when-the-largest-oil-exporter-quits-the-game/#6feb7f779ac7.

[19] James Russell, "Saudi Arabia: The Strategic Dimensions of Environmental Insecurity," *Middle East Policy* 23, no. 2 (2016): 44–58. doi://dx.doi.org/10.1111/mepo.12194.

[20] Ibid.

[21] "Davos 2017 - Saudi Arabia Vision 2030," YouTube video, World Economic Forum, January 19, 2017, https://www.youtube.com/watch?v=ef8fjnTFGGo.

[22] "Vision 2030," Kingdom of Saudi Arabia, 7–27.

Public Investment Fund Restructuring, Human Capital, National Transformation, Strengthening Public Sector Governance, Privatization, and Strategic Partnerships.[23] Several of these projects are quite broad, while others focus on one specific topic. The subcomponent programs will commence in a phased approach over the next decade.

The first and most significant initiative so far is the National Transformation Program (NTP), which gained attention as the umbrella project for many of the other items listed previously. The NTP essentially replaced the 10th five-year development plan.[24] The program outlines 178 objectives and 340 targets related to public finance, investment policy, jobs, privatization, exports, the business environment, the role of women, energy, mining, and health care.[25]

The Fiscal Balance Program (FBP) is the second major initiative that the government made public. Like the NTP, the target date is 2020. Jadwa Investment's analysis of the initiative's impact is significant, estimating a savings of SR362 billion if all targets are met.[26] This analysis differs slightly from FBP calculations, but the conclusion is similar to the government's view that the FBP can enable a budget surplus.

23 Ibid., 78–83.

24 "Saudi Arabia's New Development Plan Shows Clear Commitment to Education and the Private Sector," Oxford Business Group, Accessed August 22, 2017, https://www.oxfordbusinessgroup.com/analysis/long-game-new-development-plan-shows-clear-commitment-education-and-private-sector.

25 Ahmed Feteha, "A Quick Guide to the Saudi National Transformation Program," Bloomberg, June 7, 2016, https://www.bloomberg.com/news/articles/2016-06-06/the-saudi-national-transformation-program-what-we-know-so-far; Simon Henderson, "Vision or Mirage? Saudi Arabia's Ambitious Economic Plans," The Washington Institute for Near East Policy, June 17, 2016, http://www.washingtoninstitute.org/policy-analysis/view/vision-or-mirage-saudi-arabias-ambitious-economic-plans.

26 "Fiscal Balance Program: The Path to Fiscal Sustainability," Jadwa Investment, February 27, 2017, http://www.jadwa.com/en/researchsection/research/economic-research/macroeconomic-reports.

Economic targets	
Labor markets	• Unemployment to be reduced from 11.6 percent currently to 7 percent (9 percent by 2020). • Women's participation in workforce to be increased from 22 percent currently to 30 percent (28 percent by 2020). • Create 450,000 jobs in nongovernment sector by 2020. • Reduce civil service workforce by 20 percent by 2020.
Trade	• Share of non-oil exports to be increased to 50 percent of total from current 16 percent.
Fiscal	• Non-oil revenue to be increased from SR163 billion in 2015 to SR1 trillion by 2030 (SR530 billion by 2020). • Reduce wages and salaries as share of budget spending. • Achieve balanced budget.
Subsidy reform	• Subsidies to be removed; direct cash payments to low and middle income households who rely on subsidies.
Private and SME sectors	• Share of private sector in economy to be increased to 65 percent of GDP from 40 percent currently; SME sector contribution to be raised from 20 percent of GDP to 35 percent.
FDI	• To increase FDI share of GDP from 3.8 percent to 5.7 percent of GDP.
Sector objectives/targets	
Tourism	• Liberalizing tourist visa regime. • Plans to build world's biggest Islamic museum alongside other heritage sites • Increase number of Umrah pilgrims from abroad from 6 to 30 million per year (15 million by 2020).
Healthcare	• Plans to increase private sector role in healthcare and increase average life expectancy from 74 to 80 years.
Oil and gas	• Increase share of domestically owned (localized) oil and gas sector output from 40 percent to 75 percent.
Housing	• Focus on affordable housing and boost home ownership from 47 percent to 52 percent by 2020.
Military	• Military industry holding company to be created. Boost local participation in defense production.
Education	• Curriculum modernization; greater focus on training teachers and measuring performance.
Productivity	• To move into top-10 position on Global Competitiveness Index (25th currently). • Raise ranking in Global Logistics Performance Index from 49th place currently to 25th. • Raise ranking within Government Effectiveness Index from 80th currently to 20th.
Immigration policy	• Green card-like program for foreign workers within five years. • Visa exemption for expats working in King Abdullah business district.
Aramco	• IPO of up to 5 percent equity stake; dual listing likely. Government estimates value of Aramco at over $2 trillion.
Public Investment Fund (PIF)	• SWF to be created to diversify away from oil. PIF assets to be increased from SR600 billion currently to SR7 trillion by 2030.

All targets are for 2030, unless otherwise stated.
Source: Vision 2030 and National Transformation Program.

Figure 1. Key Economic Targets of Vision 2030 and NTP[27]

2. Challenges

Saudi Arabia faces several key political, social, and economic challenges. Some of the problems are new but many have persisted for years. The 2016 Annual Meeting of

[27] Source: International Monetary Fund, Middle East and Central Asia Dept. "Saudi Arabia: Staff Report for the 2016 Article IV Consultation," International Monetary Fund, October 13, 2016, 15, http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Saudi-Arabia-2016-Article-IV-Consultation-Press-Release-Staff-Report-and-Informational-Annex-44328.

Arab Ministers of Finance, an IMF sponsored forum, framed the issue this way: "Oil-exporting Arab countries face three-pronged policy challenges: creating jobs in line with rapidly growing population, sheltering their economy from volatility of oil prices and ensuring sustainable growth once oil resources are depleted."[28] Saudi Arabia fits such a description, but its case is more complex. Projections for oil prices that are necessary to maintain the rentier state of today estimate a requirement of $175 per barrel in 2025 and $320 by 2030.[29] The monarchy must determine how to maintain its position while integrating its traditional society into global norms and into a world that seeks to reduce its dependence on crude oil for its energy needs.[30] The leadership must also balance internal change with geopolitics, particularly its rivalry with Iran, which includes the war in Yemen.[31] Essentially, as Simon Henderson notes, "The policy challenge is how to do all this—war and economic transformation—in a period of sustained low oil prices, which, in a world of high U.S. shale production, may well not see the same cyclical recovery as in the past."[32]

a. Thriving Economy

The most significant economic and social challenge that the country faces is reducing unemployment of its citizens. This problem is multi-layered. Overall unemployment is around 12 percent, but the rate for women exceeds 30 percent, as highlighted in Figure 2. Just as important as creating jobs for women is creating jobs for young people, since unemployment for Saudis aged 15–24 is approximately 30 percent.[33]

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28 IMF Staff, "Economic Diversification in Oil-Exporting Arab Countries," International Monetary Fund, April 2016, 7, https://www.imf.org/external/np/pp/eng/2016/042916.pdf.

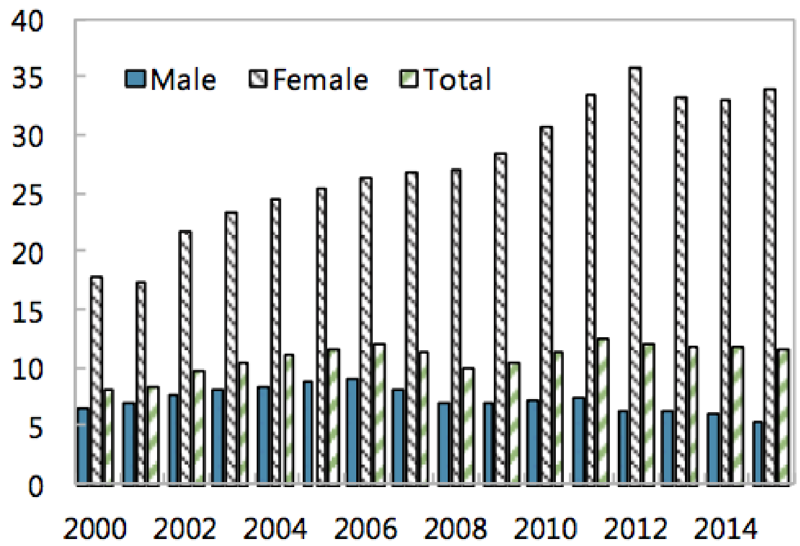
29 Robert Looney, "Saudi Arabia: Out of Options?" *Milken Institute Review*, September 15, 2016, http://www.milkenreview.org/articles/saudi-arabia-out-of-options.

30 James Russell, "In the Furnace: Saudi Arabia and the Dynamics of Global Climate Change," in *Handbook of Transitions to Energy and Climate Security*, ed. Robert E. Looney (New York: Routledge, 2017) 111.

31 Amy Myers Jaffe and Jareer Elass, "War and the Oil Price Cycle," *Journal of International Affairs 69*, no. 1 (2016), https://jia.sipa.columbia.edu/war-oil-price-cycle.

32 Simon Henderson, "Saudi Foreign Policy vs. Economic Priorities," The Cipher Brief, September 30, 2016, https://www.thecipherbrief.com/article/middle-east/saudi-foreign-policy-vs-economic-priorities-1094.

33 World Economic Forum, "Saudi Arabia Profile," Human Capital Index 2016, http://reports.weforum.org/human-capital-report-2016/economies/#economy=SAU.



Percent of total labor force for each gender

Figure 2. Unemployment Rate of Nationals by Gender[34]

Creating new jobs for the right demographic groups is necessary but insufficient to tackle unemployment. Saudization is vitally important for the future of the country. The public sector has long been the preferred employer of choice for its citizens, but minimum capacity remains for the bureaucracy to take on more employees into government service as a function of the state's patronage system.[35] Although the oil sector drives the economy, it produces relatively few jobs since it is primarily a capital-intensive industry.[36] The private sector employs vastly more people than the public sector, but low cost foreign workers fill the majority of these positions.

Oil itself has several characteristics that lead to negative outcomes.[37] Oil is nonrenewable and is not produced, so the amount of revenue that oil can generate is ultimately finite. Dependency on oil rents does not force the economy to generate

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34 Source: IMF Staff, "2016 Article IV Consultation," 36.

35 Steffen Hertog, "A Comparative Assessment of Labor Market Nationalization Policies in the GCC," in *National Employment, Migration, and Education in the GCC*, ed. Steffen Hertog (Berlin: Gerlach Press, 2012), 65.

36 Giacomo Luciani, "From Price Taker to Price Maker? Saudi Arabia and the World Oil Market," in *Saudi Arabia in Transition: Insights on Social, Political, Economic, and Religious Change*, ed. Bernard Haykel, Thomas Hegghammer, and Stéphane Lacroix (New York: Cambridge University Press, 2015), 92.

37 Luciani, "From Price Taker to Price Maker?" 72–75.

tradable goods in the same way that is necessary in resource poor countries, which has stunted the expansion of private manufacturing beyond downstream petroleum production.[38] Oil prices are also notoriously volatile. Since 90 percent of the state's revenue is from hydrocarbons that flow through Aramco, the government's revenues are subject to market volatility.[39] This outcome makes budget planning difficult, with pro-cyclical fiscal policies leading to current accounts repeatedly falling short of expectations and needs, as noted in Figure 3. The kingdom has enjoyed its status as the world's swing oil producer over the past several decades, a result of producing at the lowest cost that enabled the kingdom to somewhat affect market prices. The shale revolution in the United States and Canada threatens this ability. Also, peak demand is now a greater concern for leading crude exporters instead of peak supply, due to increased competition, the anticipated rise of renewables and global climate change policies.[40]

SR Billion	No reform	With reform	Diff.
Oil revenue	586	586	0
Non-oil revenue	234	321	87
Energy price reform	0	209	209
Total revenue	820	1,116	296
Total spending	1,020	953	-67
Fiscal balance	**-200**	**162**	**362**

Figure 3. 2020 Budget Scenario[41]

38 Ibid.

39 Gassan Al-Kibsi et al., "Moving Saudi Arabia's Economy Beyond Oil," McKinsey Global Institute, December 2015, http://www.mckinsey.com/global-themes/employment-and-growth/moving-saudi-arabias-economy-beyond-oil.

40 Kristian Coates Ulrichsen, "Resource Security in Saudi Arabia: Domestic Challenges and Global Implications," in *The New Politics of Strategic Resources: Energy and Food Security Challenges in the 21st Century*, ed. David Steven, Emily O'Brien, and Bruce Jones (Washington, DC, Brookings Institution Press, 2015), 176–80.

41 Source: Jadwa Investment, "Fiscal Balance Program."

b. Vibrant Society

The monarchy needs to effectively manage the expectations of its burgeoning youth population.[42] The primary channel to address this issue is by addressing unemployment, as mentioned above. The number of young Saudis entering the labor market each year outpaces the number of private sector jobs that the economy is currently creating.[43] Opportunities beyond employment are also necessary. Changes in education are taking root to adequately prepare young people to compete in international markets, but many graduates still enter the labor market after being groomed to become a bureaucrat.

Enabling stronger human capital is necessary for all, but the country is underutilizing its female workforce. More women than men now graduate from Saudi universities, but many do not put their skills to use professionally. The kingdom has an untapped labor resource that it could activate if it can shift attitudes about the role of women in the workplace. This solution is simple and necessary, but it will not necessarily be easy to overcome long-standing prejudices.

Unlike the region's republics, the Saudi monarchy had the resources to buy off dissent among its population during the Arab Spring. The budget projections above indicate that the state may not have this ability in the future, and thus would likely resort to repression as was the case in Egypt, Syria, etc. This prospect is dangerous for maintaining the monarchy's legitimacy.

c. Ambitious Nation

Governance improvements are necessary to improve the bureaucracy's effectiveness, and therefore the chances of improving the structure of the economy and the quality of life for the kingdom's citizens. While unveiling Vision 2030, MbS stated that improving transparency is important if the Saudi economy is to become more competitive

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[42] Bernard Haykel, Thomas Hegghammer, and Stéphane Lacroix. "Introduction," in *Saudi Arabia in Transition: Insights on Social, Political, Economic, and Religious Change,* ed. Bernard Haykel, Thomas Hegghammer, and Stéphane Lacroix (New York: Cambridge University Press, 2015), 2.

[43] Hertog, "A Comparative Assessment of Labor Market Nationalization Policies in the GCC," 65–68.

globally.[44] Improving transparency is a repeated prescription in the academic literature for combatting corruption and other ills associated with natural resource exports.

Improving the government's capacity is also needed to address the country's international public image. Within the context of reform, the primary necessity is attracting foreign direct investment (FDI). External investment is needed to drive industrial diversification and growth and to fund the reform programs themselves. The budget for the NTP alone is $72 billion.[45] Changing the world's view of Saudi Arabia from a country that places minimal attention on human rights or hosts the cradle of Wahhabi extremism to one that represents an excellent business opportunity requires fundamentally different views and practices from within the monarchy and the government.

C. RESEARCH QUESTION

The government's attempts to diversify the economy, privatize productive industries, and employ Saudi citizens in the private sector throughout the nine development plans produced insufficient change. Given this history and the similarity of the central aims of Vision 2030, this thesis seeks to answer the following question: What are the primary institutional barriers to economic and social reform in Saudi Arabia?

1. Hypotheses

The three following chapters examine one hypothesis each: social, political, and economic, respectively. The first area of focus is that the structure of Saudi government and society is sufficiently divided to prevent implementation of reform on a consistent basis. The ministries within the Saudi bureaucracy are not all created equal, and examining the multi-layered vertical power structures within them enables a more detailed understanding of where bottlenecks occur even when the Council of Ministers implements policy changes. This perspective dovetails into a discussion of the rentier

[44] "Full Transcript of Prince Mohammed bin Salman's Al Arabiya interview," Al Arabiya, April 25, 2016, https://english.alarabiya.net/en/media/inside-the-newsroom/2016/04/25/Full-Transcript-of-Prince-Mohammed-bin-Salman-s-Al-Arabiya-interview.html.

[45] "Saudi National Transformation Plan Aims for Revenue Surge," Arab News, June 7, 2016, http://www.arabnews.com/node/935796/saudi-arabia.

social contract between the people and the monarchy, which imposes limits on the latitude of decisions available to the elites that govern via patronage. Finally, entrenched vested interests that will lose influence under social and economic liberalization and modernization are likely to do what they can to delay implementation of reforms that threaten their position.

A second possibility is that Saudi Arabia suffers from the resource curse, where reliance on externally derived natural resource rents leads to a host of political and economic problems, including weak state capacity, that are structural in nature and hence very difficult to resolve. The autocratic monarchy should have the ability to impose domestic reforms at will, but this has clearly not been the case. Windfall profits that occur during boom periods delay the need to implement changes that increase sustainability. Exporters with high levels of rent fall into a "staple trap" that shapes elite behavior, retards growth, and reduces the likelihood of structural reform.[46] This tendency of resource centered economies to struggle with diversification is reflected in Saudi Arabia by oil's continued dominance, which limits the country's ability to move through economic stages that support long term growth.

A third hypothesis is that market inefficiencies limit the scope of what activities the Saudi economy can perform, stunting implementation of policies that would benefit the country. The key manifestation is in the labor market, where Saudi citizens' overall human capital is too expensive and insufficiently skilled to boost Total Factor Productivity (TFP). Labor problems coincide with the need to expand the manufacturing base into new markets in the face of competition from well-established producers. Further complicating diversification is that the country's sole comparative advantage is access to cheap energy, and that the economy's competitiveness is tied to the volatile macroeconomic environment.

[46] Richard Auty, "The Oil Curse: Causes, Consequences, and Policy Implications," in *Handbook of Oil Politics*, ed. Robert E. Looney (New York: Routledge, 2012), 340.

2. Significance

Determining the most significant reform roadblocks highlights current strengths and weaknesses, which increases understanding of how Vision 2030 is likely to succeed and struggle. The program's success will greatly impact how KSA will change over the next several decades. It is impossible to say what percentage of the vision will materialize, but the amount of change that Vision 2030 achieves will directly impact the region and the rest of the world.[47]

Informed policy choices that shape U.S.-Saudi bilateral relations rely on knowledge of Saudi strengths and weaknesses. A more sustainable model enables Saudi leadership to choose from a wider range of options for employing resources, including efforts to reduce dependence on U.S. security.[48] America's relationship with the kingdom impacts other regional alliances, made clear via KSA instituting an embargo and cutting diplomatic ties with Qatar following President Trump's May 2017 trip to Riyadh.[49]

Understanding how the Saudi economy can change is important to American businesses active in the region. Besides energy corporations, manufacturing firms such as General Electric and Dow Chemical continue to play a role in the country's industrial development.[50] Successful diversification will create opportunities for additional companies to invest in other fields. The government is actively seeking to boost FDI through the efforts of the Saudi Arabian General Investment Authority (SAGIA), but also by sending prominent ministers to promote the country at economic and academic conferences (e.g., World Economic Forum, Washington think tanks).[51]

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[47] Karen E. Young, "Can the Saudi Economy Be Reformed?" Arab Gulf States Institute in Washington, November 28, 2016, http://www.agsiw.org/can-saudi-economy-reformed/.

[48] Gregory Gause, "The Future of U.S.-Saudi Relations: The Kingdom and the Power," *Foreign Affairs* 95, no. 4 (Jul, 2016): 114–126, http://libproxy.nps.edu/login?url=http://search.proquest.com/docview/1801887506?accountid=12702.

[49] Mark Landler, "Trump Takes Credit for Saudi Move Against Qatar, a U.S. Military Partner," *New York Times*, June 6, 2017, https://www.nytimes.com/2017/06/06/world/middleeast/trump-qatar-saudi-arabia.html; Katrina Manson, "Qatar and Arab rivals play different sides of team Trump," *Financial Times*, July 4, 2017, https://www.ft.com/content/f1f4c6ee-608d-11e7-91a7-502f7ee26895?mhq5j=e1.

[50] "Deals Signed During Donald Trump's Saudi Arabia Visit," The National, May 21, 2017, https://www.thenational.ae/world/deals-signed-during-donald-trump-s-saudi-arabia-visit-1.76286.

[51] "Davos 2017 - Saudi Arabia Vision 2030," YouTube video, World Economic Forum, January 19, 2017, https://www.youtube.com/watch?v=ef8fjnTFGGo.

The Saudi Arabia that emerges throughout and after Vision 2030 will shape the kingdom’s political and economic relationships with other key countries. Saudi Arabia and Iran dominate the Persian Gulf and are central figures in the larger Middle East. Their competition for regional hegemony is long running and continuously evolving, and a Saudi internal shakeup will impact the kingdom’s ability to fight the proxy wars where these states face off. Changes to Saudi energy policy will impact KSA’s customers and competitors, specifically China’s efforts to shift its economy from an export to consumer driven model. Reduced Saudi crude production that seeks to raise prices is already presenting opportunities for other producers to fill the void. Saudi diversification away from oil will reshape the international energy market.

II. STATE AND SOCIETY

A. INTRODUCTION

Saudi Arabia's status as a rentier state shapes the structure of the government and society, sufficiently dividing institutions to prevent implementation of reform on a consistent basis. The ministries within the Saudi bureaucracy are not all created equal, and examining the multi-layered vertical power structures within them enables a more detailed understanding of where bottlenecks occur, even when the Council of Ministers implements policy changes. This perspective dovetails into a discussion of the social contract between the people and the government. The monarchy needs to modify the rentier bargain without ceding authority, which imposes limits on the latitude of decisions available to elites. Saudi Arabian society is very traditional, so change must come from within and occur at a pace that the population can accept. Despite Vision 2030's aggressive benchmark timelines, the population is not poised to undergo social and economic shock therapy. Also, entrenched vested interests that will lose influence under social and economic liberalization and modernization are likely to do what they can to delay implementation of reforms that threaten their position.

Although Saudi Arabia's political economy is typically considered the prime example of a rentier state, recent research indicates that the story is actually more nuanced. The patronage that underpins the system creates constraints on the monarchy's ability to act autonomously with little consideration of popular will. The government's participation in the economy hampers private sector growth, while its attempts to create jobs for Saudi citizens are also out of sync with its desire to promote privatization.

B. POLITICAL ECONOMY

The modern state of Saudi Arabia that King Abdulaziz Al Saud founded is just 85 years old. The amount of development and state building that occurred during this time is drastically compressed compared to state formation processes in Europe that spanned centuries. Saudi Arabia is distinct from most other Middle East and North African (MENA) states because it is one of few areas that Europe never colonized. External influence in the country for the last 200 years has primarily come in the form of economic interests that center on oil exploration and production, in addition to external security provided by the United Kingdom and the United States in the 20th century.

Middle Eastern states fall into two broad political categories based on regime type, specifically republics and monarchies. Melani Cammett et al. classify states into three economic groups based on oil rents per capita:[52] Resource Rich Labor Poor (RRLP) have oil rents per capita of at least $10,000; Resource Rich Labor Abundant (RRLA) at $250-10,000 per capita; and Resource Poor Labor Abundant (RPLA) produce less than $250 per capita. Saudi Arabia falls into the RRLP category along with the rest of the GCC.[53] The kingdom is a high-income country, although it has the next to lowest GDP per capita in the GCC due to its larger population.[54]

1. Political System

Unlike modern constitutional monarchies, the Saudi king is both head of state and head of government. The king is also the prime minister, so matters of state flow through him, as show in Figure 4. He authorizes appointments to the Council of Ministers, the body that heads the bureaucracy. Many of the top members of the royal family chair one or several of the kingdom's 22 ministries, although some ministers are non-royal technocrats.[55] The Shura Council is a second important body that can submit legislation for the king's approval. The country does not have a parliament or political parties. The 13 regions have royally appointed governors, but citizens do elect local leaders. The constitution is officially the Quran and the Sunna, although the Basic Law comprises

[52] Melani Cammett et al., *A Political Economy of the Middle East* (Boulder, CO: Westview Press, 2015), 24–26.

[53] Ibid.

[54] "World Bank Country and Lending Groups," The World Bank, Accessed August 22, 2017, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519; "GDP Per Capita (Constant 2010 US$)," The World Bank, Accessed August 22, 2017, http://data.worldbank.org/indicator/NY.GDP.PCAP.KD?contextual=region&end=2016&locations=SA&start=2012.

[55] "About Saudi Arabia," Royal Embassy of Saudi Arabia, Washington, DC, https://www.saudiembassy.net/about-saudi-arabia.

additional legislation. The legal system is organized categorically, with the majority of cases going before Shari'ah courts.[56]

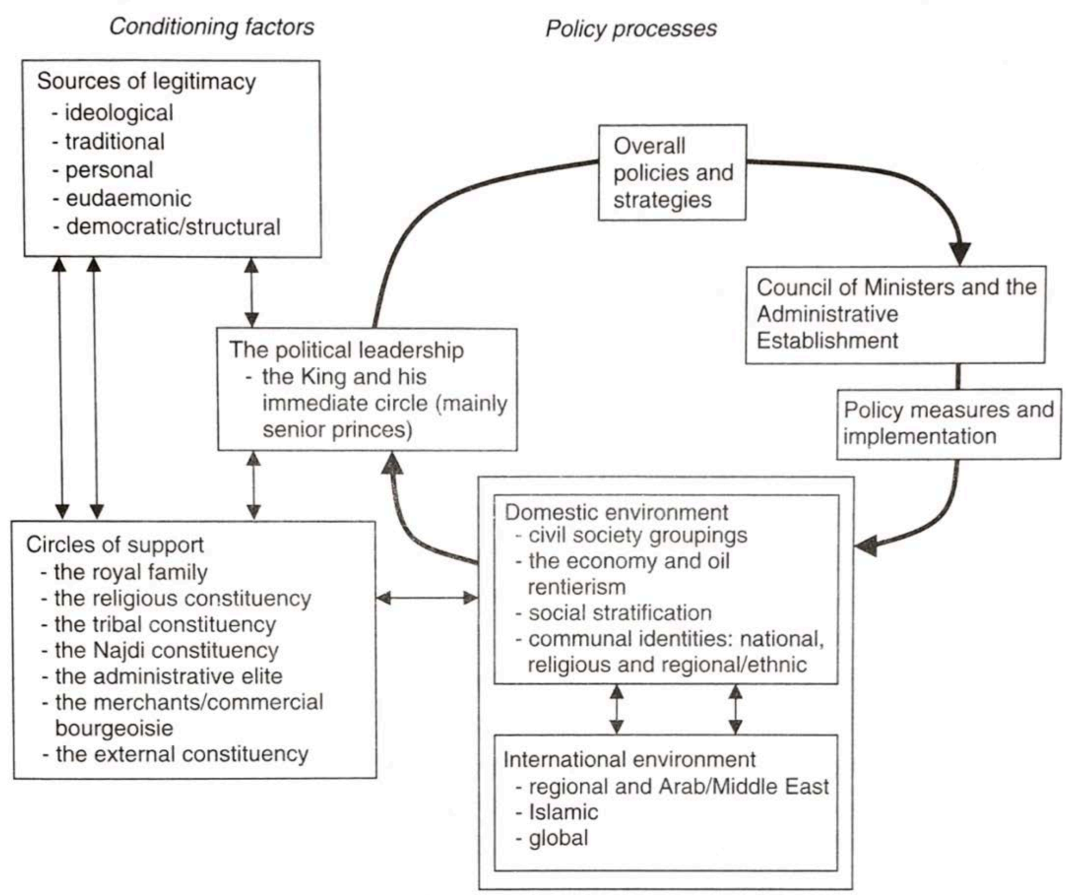

Figure 4. The Dynamics of Saudi Arabian Politics[57]

a. Rentier State

Hazem Beblawi modernized the rentier concept after studying the impacts of Gulf states' oil revenue windfalls in the 1970s.[58] In these economies, a small percentage of the

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56 "About Saudi Arabia," Royal Embassy of Saudi Arabia.

57 Source: Niblock, Saudi Arabia, 9.

58 Hazem Beblawi, "The Rentier State in the Arab World," *Arab Studies Quarterly* 9, no. 4 (Fall, 1987): 384–86.

population generates externally derived rents, which ultimately accrue to the government. Economic rent is defined as “The difference between the market price of a good or factor of production and its opportunity cost.”[59]

No single, unified definition of rentier theory exists, highlighted by Matthew Gray’s three stages that shape the history of the narrative.[60] Three key themes do circulate widely throughout the literature.[61] First, the external nature of such rents removes the need for governments to tax the population, so the state focuses on distribution of resources. The net result is that the state is not accountable to the people, which enables politicians to act autonomously since there is “No representation without taxation.”[62] Second, the distributive policies weaken state capacity, since there is no need to penetrate society in order to manage tax revenues.[63] This degrades the quality of the institutions that support the business environment. Additionally, rent-seeking behavior is more profitable than increasing productive activity, stunting the need to diversify the composition of a country’s GDP. Third, the state becomes the center of the economy and society.[64] Patronage shapes social constructs and limits the ability of civil society to bargain with the elite.

The existing Saudi social contract between the state and society is a tradeoff that fits the above distributive system, with the government allocating resources via multiple forms of patronage in exchange for political submission to the al-Saud family’s rule with minimal expressions of political dissent. In essence, the king buys the people’s loyalty with oil rents. As long as citizens’ needs are met, the king can operate with relative autonomy. Jean-François Seznec argues that the macroeconomic climate is rendering the

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59 Cammett, *A Political Economy of the Middle East*, 45.

60 Matthew Gray, “A Theory of ‘Late Rentierism’ in the Arab States of the Gulf,” Occasional Paper 7, Washington, DC: Center for International and Regional Studies, Georgetown University (2011), 24.

61 Hertog, *Princes, Brokers, and Bureaucrats*, 264–66.

62 Giacomo Luciani, “Allocation vs. Production States: A Theoretical Framework,” in *The Arab State*, ed. Giacomo Luciani (Berkeley: University of California Press, 1990), 77.

63 Hertog, *Princes, Brokers, and Bureaucrats*, 264–66.

64 Ibid.

Saudi rentier dynamic as unviable, but he also cautions that introducing taxation does not always lead to representation.[65]

Gause and Hertog qualify the Saudi experience compared to the traditional understanding of the rentier state.[66] They both counter Kiren Aziz Chaudhry's argument that the absence of taxation precludes the government from penetrating society, thus making it less capable than the pre-oil Saudi state.[67] Evidence against this notion is that the government utilizes alternative mechanisms that make it central to lives of its people and to the operation of the economy. Gause goes on to argue that KSA has acted as an "Oil state exception," because it avoided political change despite several periods of prolonged fiscal woes by leveraging large foreign reserves, relying on internal debt through the country's banks, and using its position as the world's crude oil swing producer.[68] Jane Kinninmont highlights that the monarchy's ability to again delay economic reform via such methods is at an end, although external pressures are not yet forcing political reform.[69]

b. Fractured Government

Hertog argues that the Saudi government and its society is more complexly divided compared to the unified state that is used as the level of analysis in the rentier narrative.[70] His analysis of the processes required to enact the Foreign Investment Act in 2000 and to complete accession to the World Trade Organization in 2005, which were the most significant reform outcomes of the past few decades, reveal that while support for

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65 Jean-François Seznec, "Saudi Energy Changes: The End of the Rentier State?" Atlantic Council, March 24, 2016, 14, http://www.atlanticcouncil.org/images/publications/Saudi_Energy_Changes_web_0323.pdf.

66 Gregory Gause, "Oil and Political Mobilization in Saudi Arabia," in *Saudi Arabia in Transition*, 15; Hertog, Princes, Brokers, and Bureaucrats, 265, 272.

67 Kiren Aziz Chaudhry, *The Price of Wealth: Economies and Institutions in the Middle East* (New York: Cornell University Press, 1997), 6–16.

68 Gregory Gause, "Oil and Political Mobilization in Saudi Arabia," in *Saudi Arabia in Transition*, 28.

69 Jane Kinninmont, "Vision 2030 and Saudi Arabia's Social Contract: Austerity and Transformation," Chatham House, July 20, 2017, 42, https://www.chathamhouse.org/publication/vision-2030-and-saudi-arabias-social-contract-austerity-and-transformation.

70 Hertog, *Princes, Brokers, and Bureaucrats*, 181, 243.

these measures was mixed in government and society, internal divisions diluted and delayed the final outcomes.[71]

Hertog claims that "It is the clientelist and fragmented nature of the Saudi system, both formal and informal, and the accompanying dominance of vertical links that explain specific coordination failures and bureaucratic capacity problems."[72] The bureaucracy operates like a wheel with spokes, where the king is at the center and each minister is the conduit between the hub and the various ministries located on the spokes.[73] Some parts of the government integrate with each other, but most operate separately. The system breaks down into macro, meso, and micro sub-levels, in addition to creating avenues for brokers to connect individuals to the patronage apparatus, (e.g., sponsoring foreign businesses).[74]

The divisions among ministries also perpetuated the failure of Saudization, but in this example disorganization was the key problem.[75] Significant support existed for various iterations of the long-standing policy, prompting individual elites to pursue public recognition for their efforts to make the private sector an engine of job creation for citizens. The outcome was that the Ministries of Interior, Labor, Commerce, Justice, etc., operated essentially independently, pursuing different approaches that were uncoordinated at a higher level.[76] The dynamic of many small, segregated steps produced little progress toward achieving desired results.

2. State and Economy

Crude oil exports drive the economy, although expansion into other sectors over the last several decades elevated Saudi manufacturing beyond the productive capacity of

[71] Hertog, *Princes, Brokers, and Bureaucrats*, 248–52.

[72] Ibid., 246.

[73] Ibid.

[74] Ibid., 248–53.

[75] Ibid., 219.

[76] Ibid.

the rest of the GCC and the majority of MENA states.[77] The public sector contains the country's largest firms, including oil giant Saudi Aramco. The government's privatization efforts to date primarily consist of creating Public Private Partnerships (PPP). Chemical producer Saudi Basic Industries Corporation (SABIC) is the most notable example, with the state owning 70 percent of the company.[78]

Figure 5 shows the impact of the sharp decreases in global oil prices in 2014, which led to the first budget and current account deficits in years. Figure 6 provides greater detail of the scope of the kingdom's weakened fiscal environment. The IMF assesses with high probability that "Persistently low energy prices" will continue for the foreseeable future, a stance that reflects the general consensus that shale production is leading to sufficient oversupply to minimize the impact of OPEC's production cuts that started in late 2016.[79]

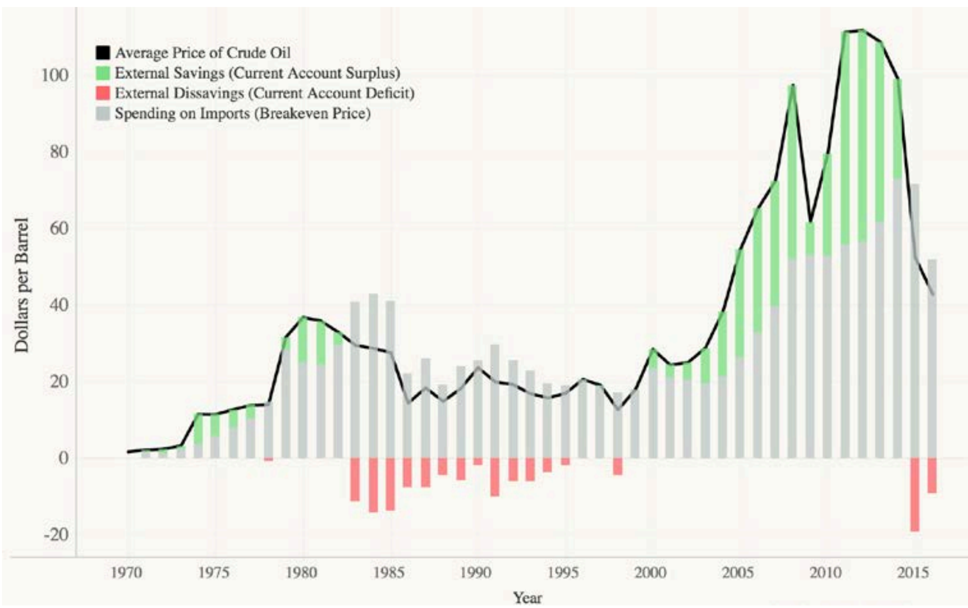


Figure 5. KSA Breakeven Oil Price[80]

[77] Jean-François Seznec, "Introduction," in *Industrialization in the Gulf: A Socioeconomic Revolution*, ed. Jean-François Seznec and Mimi Kirk (New York: Routledge, 2011), 1–3.

[78] "About Us," SABIC, Accessed August 22, 2017, https://www.sabic.com/en/about.

[79] IMF Staff, "2016 Article IV Consultation," 10.

[80] Source: Brad W. Setser and Cole Frank, "Oil Exporters' External Breakeven Prices," Council on Foreign Relations, July 11, 2017, https://www.cfr.org/report/interactive-oil-exporters-external-breakeven-prices.

	2011	2012	2013	2014	2015	Proj. 2016
Production and prices	(Annual percent change; unless otherwise stated)					
Real GDP	10.0	5.4	2.7	3.6	3.5	1.2
Real oil GDP	12.2	5.1	-1.6	2.1	4.0	0.6
Real non-oil GDP	8.1	5.5	6.4	4.8	3.1	1.6
Nominal GDP (billions of U.S. dollars)	670	734	744	754	646	646
Consumer price index (avg)	3.7	2.9	3.5	2.7	2.2	4.2
Fiscal and Financial variables	(Percent of GDP; unless otherwise stated)					
Central Government revenue	44.5	45.3	41.4	36.9	25.4	22.7
Of which: oil revenue	41.2	41.6	37.1	32.3	18.4	14.2
Central Government expenditure	33.4	33.3	35.6	40.3	41.3	35.7
Fiscal balance (deficit -)	11.2	12.0	5.8	-3.4	-15.9	-13.0
Non-oil primary balance (percent of non-oil GDP)	-61.7	-60.4	-59.7	-64.0	-50.8	-39.3
Broad money (annual percent change)	13.3	13.9	10.9	11.9	2.5	2.2
External sector	(US$ billions; unless otherwise stated)					
Exports	364.7	388.4	375.9	342.5	202.3	183.9
Of which: Oil and refined products	317.6	337.2	321.7	284.4	151.3	132.6
Imports	-120.0	-141.8	-153.3	-158.5	-155.0	-149.4
Current account	158.6	164.8	135.4	73.8	-53.5	-41.1
Current account (percent of GDP)	23.7	22.4	18.2	9.8	-8.3	-6.4
SAMA's net foreign assets	535.2	647.6	716.7	724.3	608.9	542.9
SAMA's net foreign assets (in months of imports of goods and services)	29.8	33.8	33.2	35.4	32.3	27.9
Real effective exchange rate (percent change)[1]	-3.6	3.2	3.0	9.3	8.3	3.1

Sources: Country authorities; and IMF staff estimates and projections.

[1] Latest 2016 data is for end-April.

Figure 6. Selected Economic Indicators, 2011–16[81]

a. Public to Private, Oil to Non-oil

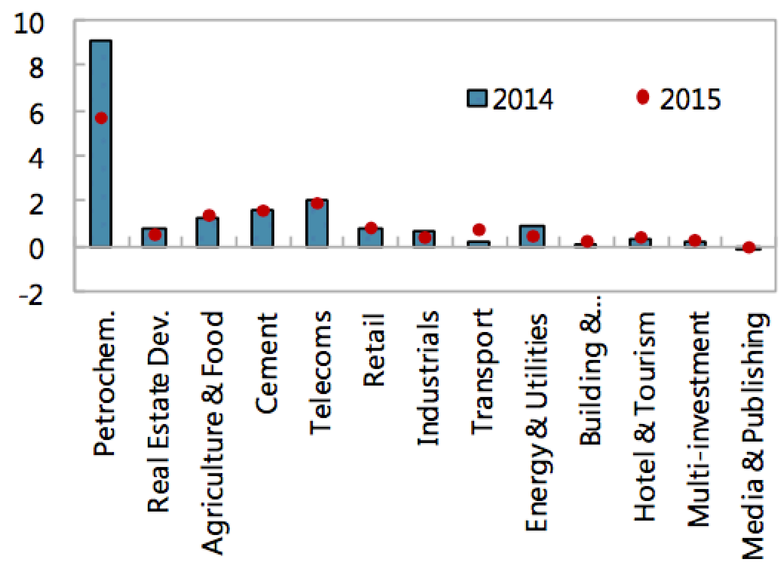
The Saudi economy has increased the size and scope of the private sector over the past several decades, but the government is still directly involved in the country's productive capacity. Besides the focus on the 2018 Aramco IPO, the NTP plans to benefit the restructuring of the Public Investment Fund (PIF) by selling or partially privatizing a wide range of government services and companies, (e.g., petrochemicals, hospitals, pharmaceuticals, airports, sea ports, postal service, electricity, desalination, agriculture, and education).[82] The government needs to convince investors that their using their

81 Source: IMF Staff, "2016 Article IV Consultation," 4.

82 "National Transformation Program," Kingdom of Saudi Arabia, 24–27, 86–100, http://vision2030.gov.sa/sites/default/files/NTP_En.pdf.

capital to support Saudi society and manufacturing will benefit shareholders as much as the Saudi state.[83]

Oil still dominates the Saudi economy, noted in Figure 7. Other industries have established some regional success, particularly plastic and petrochemical production, shown in Figure 8. These two industries benefit from access to cheap energy feedstock that go directly into the final manufactured products. Reliance on the country's competitive advantage in energy has stretched the definition of diversification of tradable goods to include upstream production, (e.g., gasoline refining, which is not truly moving the country away from its reliance on petroleum).

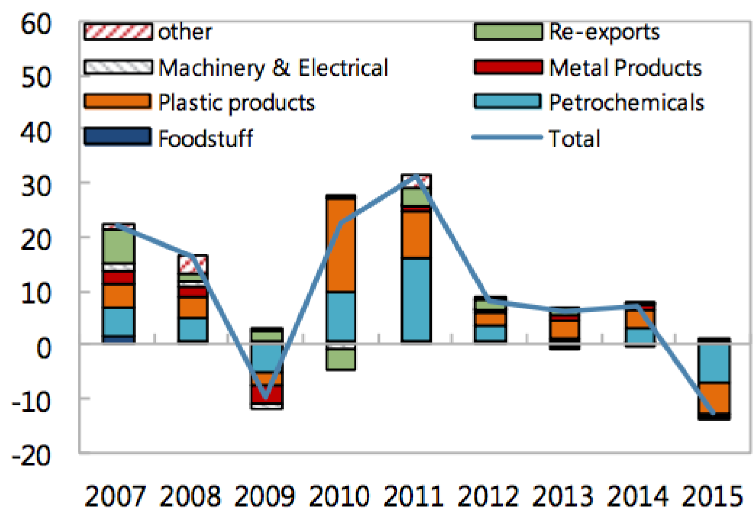


US$ billion

Figure 7. Net Incomes of Listed Saudi Corporates by Sector[84]

[83] "Saudi Arabia: Privatisation Will Privilege the State," Oxford Analytica Daily Brief Service, July 10, 2107, https://search.proquest.com/docview/1917357182?accountid=12702.

[84] Source: IMF Staff, "2016 Article IV Consultation," 31.



Percent

Figure 8. Contribution to Non-oil Export Growth[85]

b. Employment

The distribution of the citizen labor force is approximately balanced between the public and private sectors, although foreign workers dominate the private sector and overall labor market, as shown in Figure 9. Saudis in the private sector primarily work in manufacturing and agriculture, indicated in Figure 10. The real challenge is creating new jobs in the private sector for nationals that currently are unemployed or underemployed. Official statistics do not capture the impact of the informal labor market.

Creating new jobs is a simultaneous function of expanding the size and scope of the private sector. Solving unemployment is paramount, but it cannot happen under the current model. Cheap labor has been in place for decades, so employers must either become willing to pay more to hire Saudi citizens, or new jobs must arise that are designed to pay higher wages to skilled workers. This issue is examined further in Chapter IV, but it is integral to the role that the, economy plays in managing the relationship between state and society, so it is important to discuss in that context.

[85] Source: IMF Staff, "2016 Article IV Consultation," 34.

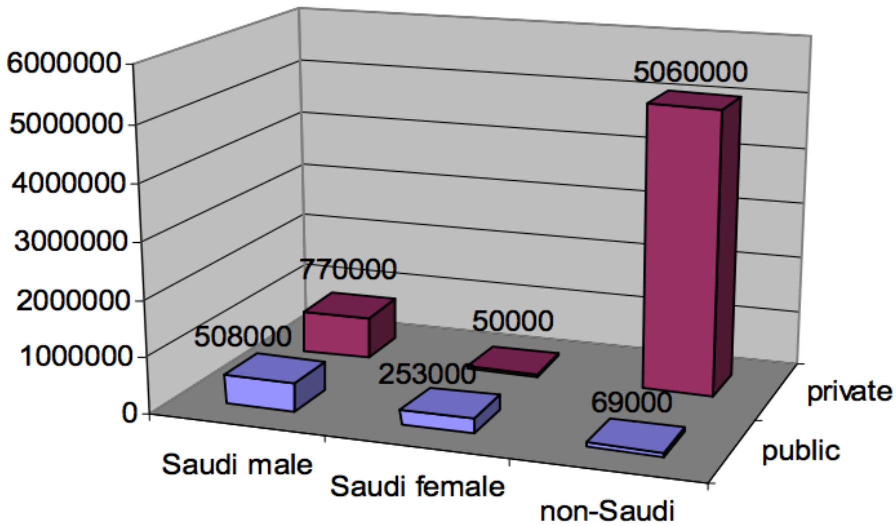
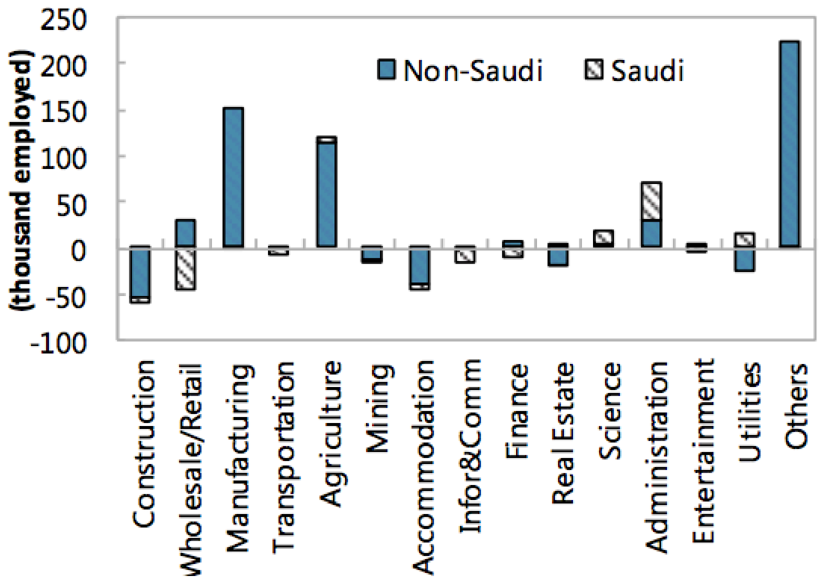


Figure 9. Saudi Labor Market Segmentation[86]



Year on year change

Figure 10. 2015 Employment in Private Sector[87]

86 Source: Hertog, "A Comparative Assessment of Labor Market Nationalization Policies in the GCC," 73.

87 Source: IMF Staff, "2016 Article IV Consultation," 36.

C. VESTED INTERESTS

A natural place to begin looking for entrenched interests that desire to maintain the status quo is in the state's key domestic relationships, particularly with the population, the clerics, and the elite. As Terry Lynn Karl notes, "Private vested interests" and the rentier state itself impede reform in oil exporters.[88] As with any time major change is introduced into a social group, those who benefit from the new circumstances strive to create the new environment, while those who stand to lose position, authority, or resources do what they can to resist. Saudi Arabia is a conservative society, although the number of active social media users has rapidly expanded over the past decade, providing inroads for outside ideas.[89] Globalization reaches into the country via King Abdullah foreign scholars. The question moving forward is to what extent are the liberal economic ideas that modernizing forces are spreading taking root among key sectors of society.

1. Rentier Bargain

MbS stated that the ultimate factor that will determine the success of the vision that he is leading is if the people come to accept and support it and the change that it represents.[90] The existing patronage construct that supports the Saudi rentier model does not give carte blanche authority to the monarchy to impose its will upon the people without consent. Gwenn Okruhlik argues that the rentier framework tends to overemphasize the importance of economics in shaping the relationship between the state and citizens in oil states.[91] She finds that many authors fail to recognize the role that politics play in forming policy. Just as important, leaders' choices influence the timing and scale of dissent. Rentier theory claims that the distributive practices that replace extractive capacity render the people voiceless, but reality is more complex.

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[88] Terry Lynn Karl, *The Paradox of Plenty* (Berkeley: University of California Press, 1997), 16.

[89] "Use of Social Media Apps in Saudi Arabia Growing Rapidly," Al Arabiya, May 26, 2016, https://english.alarabiya.net/en/media/digital/2016/05/26/Use-of-social-media-apps-in-Saudi-Arabia-rapidly-growing.html,

[90] David Ignatius, "A Young Prince is Reimagining Saudi Arabia. Can He Make His Vision Come True?" *Washington Post*, April 20, 2017, https://www.washingtonpost.com/.

[91] Gwenn Okruhlik, "Rentier Wealth, Unruly Law, and the Rise of Opposition: The Political Economy of Oil States," *Comparative Politics* 31, no. 3 (1999), 296–97, http://www.jstor.org/stable/422341.

Okruhlik's most interesting observation is that dissent occurred on at least five occasions, but during economic boom periods instead of the protracted recessions in Saudi Arabia's history.[92] The implication is that how and to whom the state provides preferential treatment does in fact create opposition forces. The kingdom's poor scores for Voice on the World Bank's governance index, which are discussed in Chapter III, tie into the monarchy's reputation for buying silence. This strategy has staved off upheaval, particularly during the throes of the Arab Spring, although it highlights the state's weakness in incorporating criticism of areas where it is weak and needs to promote reform.[93]

The government cannot force its agenda through with the expectation that opponents will sit idly by and take what the state gives them. This does not mean that the regime will chart its course based on popular opinion, but it also cannot ignore the public will. A short-lived subsidy cut that lasted from September 2016 to April 2017 demonstrated the sensitivity of public policy to popular sentiment. After reducing public sector employees' bonuses and financial perks, King Salman elected to reinstate these benefits.[94] MbS denied that popular pressure reversed the cuts, arguing that the government's deficit declined by 44 percent in the first quarter of 2017, freeing up extra cash.[95] Despite this testimony, the reality seems to be that the monarchy is sensitive to the criticism that the cuts generated from the bureaucrats upon whom it relies to carry out its policies and from the citizens with whom its ruling bargain originates. Reforms that consider popular acceptance are more likely to succeed. Acting outside of the will of the people simply furthers pro-cyclical policies that do not lead to change.[96]

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92 Okruhlik, "Rentier Wealth," 297.

93 Ulrichsen, "Resource Security in Saudi Arabia," 176–83.

94 Ben Hubbard, "Saudi Arabia Restores Public Sector Perks Amid Grumbling," *New York Times,* April 23, 2017, https://www.nytimes.com/2017/04/23/world/middleeast/saudi-arabia-king-salman.html?_r=0.

95 "Saudi Arabia's Deputy Crown Prince Mohammed bin Salman Interview," YouTube video, MBC Group, May 3, 2017, https://www.youtube.com/watch?v=dBDioH0ZITg.

96 Kinninmont, "Vision 2030 and Saudi Arabia's Social Contract," 5.

2. Clerical Opposition

The clerical establishment and reformers are bound to clash, since the implications of the reforms' social changes would be a major blow to the religious establishment's authority.[97] Reforms threaten the compact between the houses of Saud and Wahhab, which is used to establish royal legitimacy and to promote puritanical theology.[98] When previously faced with challenges emanating from outside these families, the best approach has been to coexist in order to keep their hold on politics, economics, and religion.[99] The dynamics of today's struggle are different, since change is coming from within the corridors of power; this does not mean that the notoriously conservative sector of the Saudi population will automatically embrace change.

The conservative Hanbali leaders who dominate the country's religious landscape cannot directly oppose the liberalizing forces that Vision 2030 is trying to impose on society; however, the Sunni clerical establishment plays a complex role in the country's political dynamics and possess the capacity to hamper key portions of the current reform efforts. The clerics have traditionally dominated management of the education system's curriculum.[100] Any attempts to create a knowledge based economy will require broad educational modernization.

Vision 2030 is a threat to the ulama's legitimacy. Under privatization, the business community will encroach on the cleric's market share of importance in the national psyche. Salafism's puritanical dogma is a roadblock to some, although not all, foreign investors.[101] The education system will need to prioritize secular curricula over religious teaching. Western, liberal ideals will coexist with increased global

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[97] David Gardner, "Saudi Reforms and Religion Are on a Collision Course," *Financial Times*, April 28, 2016, http://search.proquest.com/docview/1792237381/fulltext/A6C3FF431D0F46B6PQ/1?accountid=12702.

[98] Simon Henderson, "Saudi Arabia's Challenging Plan to Shift from Oil," The Washington Institute for Near East Policy, April 25, 2016, http://www.washingtoninstitute.org/policy-analysis/view/saudi-arabias-challenging-plan-to-shift-from-oil.

[99] Andrew Hammond, *The Islamic Utopia: The Illusion of Reform in Saudi Arabia* (New York: Pluto Press, 2012), 231, https://ebookcentral.proquest.com/lib/ebook-nps/reader.action?docID=3386689.

[100] Henderson, "Saudi Arabia's Challenging Plan to Shift from Oil."

[101] Gardner, "Saudi Reforms and Religion Are on a Collision Course."

integration.[102] Women may drive and go uncovered in public on the Aramco headquarters campus,[103] but little tolerance exists for these norms to expand to the rest of the country.

3. Elites Holding On

Convincing business owners to hire Saudi citizens and encouraging elites to expand business operations into new sectors requires an institutional shift to make such policies attractive and lucrative. Rent seeking exists in all economies, since all private sector companies and individuals seek to maximize profit. The opportunities to boost income via rents in the Saudi economy are greater than in most countries. Disenfranchisement from the current beneficial structure is not an incentive for the business community to simply adopt the government's new policies.

The private sector business community has benefitted from cheap foreign labor and state subsidized inputs in the pursuit of "'Wealth creation' for business owners, not 'economic value creation.'"[104] This attitude will slow the shift of viewing the private sector as a supporter of the general welfare. While business owners stand to directly gain from the proposed reforms in the long term, opposition is likely, since operating costs will drastically increase in the short to mid-term.[105]

D. SUMMARY

Political realities and interests constrain economically sound policies in all countries, but Saudi Arabia must overturn structural political obstacles to create change. The kingdom's rentier mechanisms do not fit all of the widely held arguments about state capacity, although the strong patronage ties that shape the relationship between state and

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[102] Ibid.

[103] "The Oil Kingdom: Part Two," YouTube video, CBS, December 7, 2008, https://www.youtube.com/watch?v=D1t4ue-WmlU.

[104] Bill Spindle and Ahmed al Omran, "Oil Change: Affluent Saudi Arabia Goes to Work," *Wall Street Journal*, May 31, 2016, http://search.proquest.com.libproxy.nps.edu/docview/1792609219/citation/2A38BD87C3144F79PQ/1.

[105] Andrew Scott Cooper, "Saudi Arabia's First Step Is Admitting It Has an Oil Problem," *Foreign Policy*, June 7, 2016, http://foreignpolicy.com/2016/06/07/saudi-arabia-oil-addiction-vision2030-mckinsey-mohammed-bin-salman/.

society limit the policy options available for reshaping the social contract. With no currently viable alternatives available to the government to replace its direct support of the population, it cannot expect citizens to wholeheartedly embrace a drastically different socioeconomic model to meet everyone's needs.

Patronage also creates the fractures that divide the bureaucracy and its links to society. Such a dynamic stunts policy enactment because the leadership's initial intent does not penetrate all ministries at all levels, meaning implementation does not fully take root. A byproduct of this system is that it creates space for brokers to operate as conduits between elites who manage patronage based resources and private entities, both foreign and domestic, which perpetuates rentier conditions.

The state maintains dominant positions in the economy's most profitable sectors and firms, and its plans to privatize state owned enterprises (SOE) are really designed to create more PPPs. While this is a positive step for both the public and private sectors, continued government majority ownership means that the state is not actually creating an autonomous private sector. The most successful private businesses, (e.g., Saudi Binladin Group), directly benefit from government support, in the form of contracts and tax structure, but also from access to cheap labor via the existing labor market. Chapter IV examines Saudization efforts in more detail, but essentially the government's attempts to force employers to hire citizens have not worked because they are bad for business. The result is that Saudization is currently incompatible with privatization of labor intensive industries.

Finally, groups who stand to benefit from the status quo are naturally hesitant, or even opposed, to supporting modernization and liberalization in order to prevent loss of status, influence, access, wealth, etc. The kingdom is known for its staunch conservative attitudes and customs, and authorities with a traditional mindset can slow the pace of change. What ultimately matters is how the generation of young people that dominate the country's demographics will define what it means to be Saudi once they assume leadership of the country.

III. THE RESOURCE CURSE

A. INTRODUCTION

After the oil busts of the late 1970s, academic debates questioned if countries reliant on externally derived natural resource rents actually suffer from their physical endowments since many case studies experienced a host of political and economic problems, including weak state capacity. MENA oil producers served as prime examples in the discussion. Saudi Arabia played a central role in the analysis since it is the world's largest crude oil exporter. So, how does the resource curse impact Saudi Arabia, and does it inhibit reform?

The autocratic monarchy should have the ability to impose domestic reforms at will, but this has clearly not been the case. Windfall profits that occur during boom periods delay the need to implement changes that increase sustainability. Exporters with high levels of rent fall into a "staple trap" that shapes elite behavior, retards growth, and reduces the likelihood of structural reform.[106] This tendency of resource centered economies to struggle with diversification is reflected in Saudi Arabia by oil's continued dominance, which limits the country's ability to move through economic stages that support long term growth.

Over the past two decades, critics of the classic resource curse have grown in number, and thus today there is a broad debate regarding whether the curse truly exists and if so, how and to what extent.[107] This chapter outlines the fundamentals of the curse, describing its causes and impacts, and then reviews recommendations for mitigating associated negative consequences. Most suggestions outline political remedies to mitigate the harm already done and to ideally harness the potential that these resources could produce. This enables a discussion of Saudi Arabia's experience with the curse, both in theory and as measured by real world data. After discussing the curse's impact on the

[106] Auty, "The Oil Curse," 340.

[107] Ramez Badeeb, Hooi Hooi Lean, and Jeremy Clark, "The Evolution of the Natural Resource Curse Thesis: A Critical Literature Survey," Working Paper 5/2016, University of Canterbury, 1–8, http://www.econ.canterbury.ac.nz/RePEc/cbt/econwp/1605.pdf.

kingdom, the chapter concludes with Saudi efforts designed to turn the world's largest oil reserves into a sustainable economic base.

B. THE RESOURCE CURSE

The resource curse theory argues that most natural resource exporters experience a host of political, social and economic problems. Essentially such states are actually worse off today because of oil, minerals, etc. The following section discusses the resource curse, and its more specific manifestation the oil curse, to include its consequences and causes. Also included is an analysis of debates regarding the curse's scope and applicability.

The overarching trend among oil exporters shows that countries that developed strong institutions prior to discovering hydrocarbon deposits developed diverse, industrialized economies and strong political systems.[108] Prime examples are Norway, Canada, and the United States. The vast majority of today's producers did not have strong governance when in place, either because of colonial legacy, low populations, etc.[109] The curse is found in this latter set of states that continue to attempt to stave off its effects. Michael Ross outlines three theories to explain economic policy mismanagement in resource rich states: "Cognitive explanations, which contend that resource booms produce a type of short-sightedness among policymakers; societal explanations, which argue that resource exports tend to empower . . . groups that favor growth-impeding policies; and state-centered explanations, which contend that resource booms tend to weaken state institutions."[110]

1. Theory

Starting in the late 1970s, Middle Eastern scholars hypothesized that states reliant on natural resource exports, especially crude oil and natural gas, suffer from a resource

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108 Hend Al-Sheikh and S. Nuri Erbas, "The Oil Curse and Labor Markets: The Case of Saudi Arabia," Economic Research Forum, Working Paper 697, July 2012, 3.

109 Ibid.

110 Michael L. Ross, "The Political Economy of the Resource Curse," *World Politics* 51, no. 2 (1999), 298, http://www.jstor.org/stable/25054077.

curse.[111] Western academics became interested and soon a large body of work argued that economies driven by resource derived rents underperform compared to their potential performance and suffer from multiple associated economic, political, and social consequences.[112] Further studies held that hydrocarbon resources are simply commodities that can be a curse or a blessing depending their management and overall governance. Critics stress the need for research to pay greater attention to the heterogeneity of resource producers, to consider long-term trends, and to evaluate the specific impacts of resource revenues instead of simply declaring them good or bad.[113]

a. Concept's History

The discussion of natural resources' impact on political economy began with Adam Smith.[114] Following an *Economist* article in 1977, the modern theory has rapidly grown in scope and scale; Badeeb, Hooi, and Clark provide the following milestones in the history of the discussion.[115] Cordon and Neary observed the impact of natural gas exports on the Dutch economy in 1982, prompting the now ubiquitously referenced Dutch Disease. Gelb outlined the theory in 1988, while Auty devised the term "resource curse" in 1993. Sachs and Warner conducted the first significant empirical study to support the theory in 1995, and Gylfason showed the connection between resource dependence and economic growth in 2001.

Several debates exist within the resource curse literature, primarily regarding whether mineral rents are actually a bane on resource exporters, (i.e., determining if the curse exists). The number of authors and scope of research into the problem expanded greatly in the 1990s as declining oil prices led to sustained fiscal deficits. The literature became more divisive in the 2000s, likely coincidental with the second oil boom that

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111 Badeeb, Lean, and Clark, "The Evolution of the Natural Resource Curse Thesis, 2–5.

112 Ibid.

113 Giacomo Luciani, "Introduction: The Resource Curse and the Gulf Development Challenge," in *Resources Blessed: Diversification and the Gulf Development Model*, ed. Giacomo Luciani (Berlin: Gerlach Press, 2012), 26–28.

114 Ibrahim Elbadawi and Raimundo Soto, "Resource Rents, Political Institutions, and Economic Growth," Working Paper 678, Economic Research Forum, May 2012, 2.

115 Badeeb, Lean, and Clark, "The Evolution of the Natural Resource Curse Thesis, 8.

emerged in 2002. Despite an increase in the number of challengers, recent publications, led by Ross' *Oil Curse*, maintain that the theory holds for the broad number of exporters. Division also exists regarding the measurements used to assess the curse, in addition to criticism that the theory's proponents over generalize.[116] All researchers seek to prove the applicability of theory to case studies, yet it is important to keep the heterogeneity of countries' experiences in perspective.

b. Oil Curse

Richard Auty defines the oil curse as "An extreme manifestation of a broader rent curse that is rooted in policy failure . . . and reflects the unusual capital intensity of hydrocarbon production,"[117] which Ross highlights as extremely problematic because "The revenues oil bestows on governments are unusually large, do not come from taxes, fluctuate unpredictably, and can be easily hidden."[118] This paper is primarily interested in the oil curse vice the more general resource curse since oil is vastly more important to Saudi Arabia than natural gas or other minerals. Oil has unique financial characteristics that distinguish it from other types of resources, such as price inelasticity.[119]

Oil's most important distinctions from other means of wealth generation reside in two physical properties: oil is not produced and it is nonrenewable.[120] The consequence is that oil exports are actually a liquidation of assets rather than a source of income; nonetheless, oil reliant countries treat revenues generated from oil sales as income.[121] Without converting such revenues into some form of lasting capital, the net result is a reduction of national wealth.

116 Luciani, "Introduction: The Resource Curse and the Gulf Development Challenge," 6–8.

117 Auty, "The Oil Curse," 337, 345.

118 Michael Ross, *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (Princeton, NJ: Princeton University Press, 2012), 6.

119 Paul Stevens, "Co-operation Between Producers and Consumers," in *Handbook of Oil Politics*, ed. Robert E. Looney (New York: Routledge, 2012), 84.

120 Macartan Humphreys, Jeffrey Sachs, and Joseph Stiglitz, "Introduction: What Is the Problem with Natural Resource Wealth?" in *Escaping the Resource Curse*, ed. Macartan Humphreys, Jeffrey Sachs, and Joseph Stiglitz (New York: Columbia University Press, 2007), 4.

121 Ibid.

c. Measuring Impact

The independent variables used to measure resource impact on economic performance influence conclusions about the existence of the resource curse. Several factors are important to keep in mind to obtain the clearest empirical understanding of how export revenues and rents shape a country's government and society.

First, examining data over the long term takes several factors into account.[122] The oil market and oil revenues are notoriously volatile, although price booms and busts can last for decades. Regardless of the measurement, looking at several decades of data enables more comprehensive analysis instead of confusing robust or weak performance for market conditions. Most studies rely on World Bank GDP data, which typically begins in the 1960s for the majority of countries.

What is the best method to ascertain growth? Is one variable sufficient to grasp the full picture? GDP is the simplest and most common way to discern how well a country does in a given year. Examining total output can give a general idea of how well this country is performing over time, but it is not perfect. Critics highlight that GDP is a single measure that does a poor job of accounting for the effects of innovation, quality, intangibles, and sustainability.[123] Joseph Stiglitz and Christine Lagarde have called for research into a new standard, a cry echoed by other economists who argue that GDP does not pay "Attention to what is produced, how it's produced or who is producing it."[124]

So far, no alternatives to GDP have come into the fore, but more choice exists when measuring economic impact on individuals. Like Real GDP is adjusted for inflation, and thus is a more precise tool over time than Nominal GDP, GDP per capita in terms of Purchasing Power Parity (PPP) adjusts for exchange rates to provide comparable price ratios among countries. PPP is the best indicator of the cost of living.

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122 Luciani, "Introduction: The Resource Curse and the Gulf Development Challenge," 6–8.

123 Diane Coyle, "Beyond GDP: What the Measure of Economic Performance Misses About Economic Performance," *Foreign Affairs*, February 16, 2014, https://www.foreignaffairs.com/articles/2014-02-16/beyond-gdp.

124 Ross Chainey, "Beyond GDP – is it Time to Rethink the Way We Measure Growth?" World Economic Forum, April 13, 2016, https://www.weforum.org/agenda/2016/04/beyond-gdp-is-it-time-to-rethink-the-way-we-measure-growth.

Examining rent distribution in oil exporting countries falls along similar lines. Ross argues that oil income per capita, not oil exports per capita, gives the best indicator of how oil revenues impact governments and citizens.[125] The former factors in oil prices, taking it a step beyond output alone. Ross admits that this measure is not perfect, but it remains the best available option.

2. Causes and Impact

Four qualities of oil revenues lie at the heart of the negative impacts of oil on exporters: "Their scale, source, stability, and secrecy."[126] Oil revenues can be massive, come from selling assets, fluctuate volatilely, and are not open to public audit. Ross comments that when such properties combine with poor governance and weak institutions, the outcome is often worse than if a country possessed no oil reserves.

The consensus is that the curse is a political phenomenon. Ross offers three political causative theories: cognitive: "resource booms produce a type of short-sightedness among policymakers"; societal: "resource exports tend to empower sectors, classes, or interest groups that favor growth-impeding policies"; and state-centered: "resource booms tend to weaken state institutions."[127] Economic explanations, and even the social complications, are important to consider to present a more complete picture. Ross offers four specific economic explanations: "A decline in the terms of trade for primary commodities, the instability of international commodity markets, the poor economic linkages between resource and non-resource sectors, and an ailment commonly known as the 'Dutch Disease.'"[128]

Auty identifies the oil curse with "rent cycling theory," which asserts that states with low levels of rent tend to create productive economies, while high rent states do not undergo this process, which creates the dependency that is so common among many

[125] Ross, *The Oil Curse*, 16.

[126] Ibid., 5.

[127] Ross, "Political Economy of the Resource Curse," 298.

[128] Ibid.

exporters.[129] Figure 11 outlines the processes whereby oil dependent states fall prey to this “staple trap,” which is associated with the problems and outcomes of the resource curse.

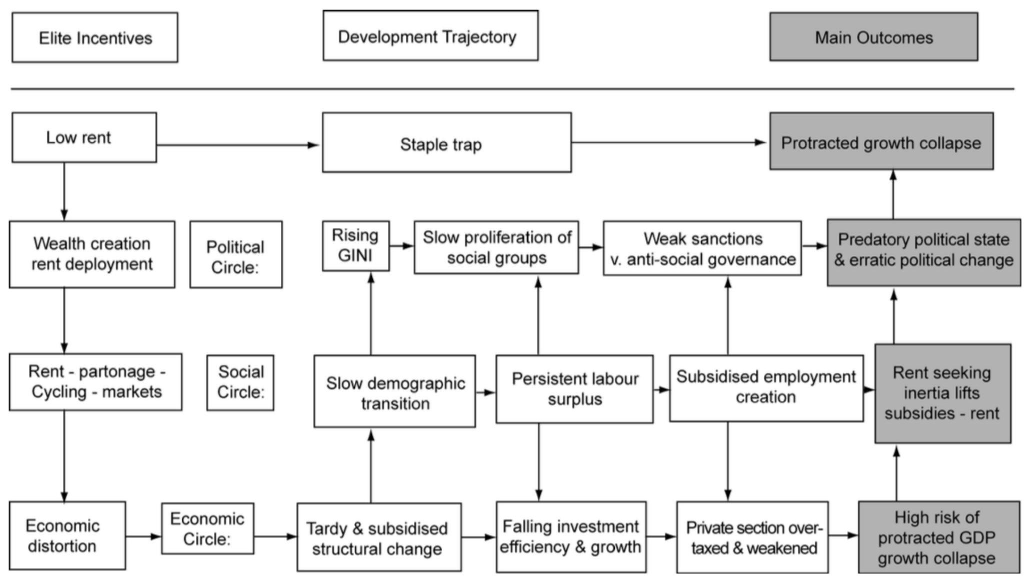

Figure 11. High Rent Competitive Industrialization Development Model[130]

a. Political

Luciani and Beblawi pioneered research on the rentier state in the 1980s, and since then this concept has joined the explanations for the curse; however, Luciani has since argued that this paradigm is not necessarily a de facto conduit to the oil curse.[131] More recent studies find that political factors are the true determinant of the extent to which resource based economies suffer from the curse. A leading explanation argues that the two key independent variables are levels of inclusiveness and how well a system coordinates and enforces its rules, defined as “intertemporal credibility.”[132] Oil producers

[129] Auty, “The Oil Curse,” 339.

[130] Ibid., 340.

[131] Luciani, “Introduction: The Resource Curse and the Gulf Development Challenge,” 6.

[132] Naazneen H. Barma et al., *Rents to Riches? The Political Economy of Natural Resource–Led Development* (Washington: The World Bank, 2012), 11, 54; Elbadawi and Soto, “Resource Rents, Political Institutions, and Economic Growth,” 1.

fall into four types of governance structures based on these criteria, shown in Figure 12. Ross et al. classify KSA as a "Hegemonic Government" due to its low level of political inclusiveness.

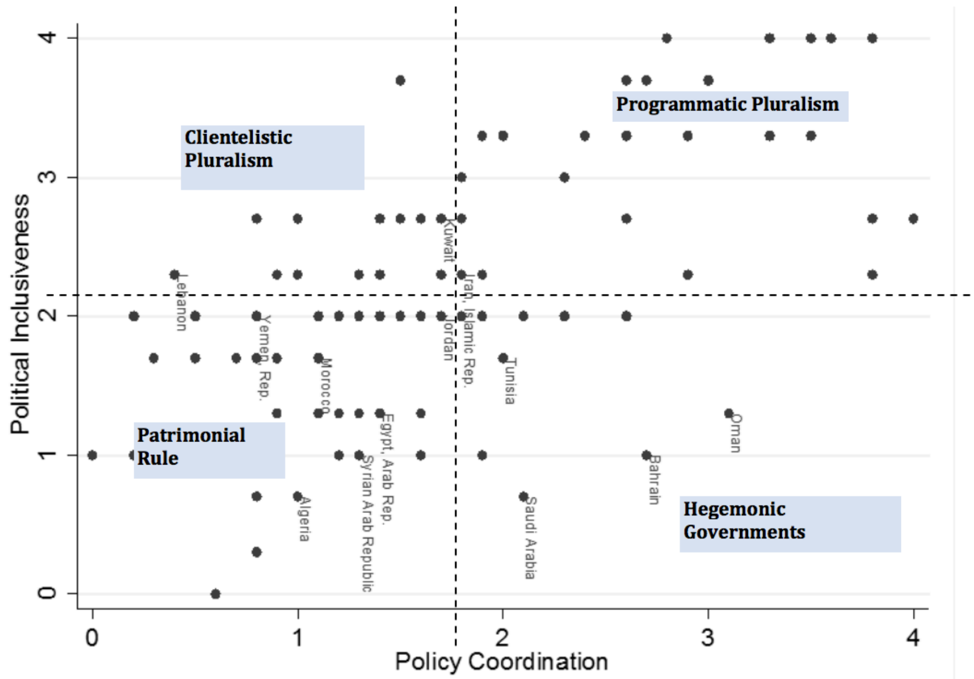

Figure 12. Overall Intertemporal Credibility and Political Inclusiveness[133]

Access to windfall profits shapes political behavior that prioritizes rent seeking, where the members of society with the means to create productive enterprises choose instead to focus their efforts on capturing the maximum possible share of revenue that the state doles out.[134] The primary repercussion of this behavior is that private industry does not operate at its potential, decreasing GDP and leaving room for the state to occupy portions of the economy that it arguably could avoid.

[133] Source: Michael Ross, Kai Kaiser, and Nima Mazaheri, "The 'Resource Curse' in MENA? Political Transitions, Resource Wealth, Economic Shocks, and Conflict Risk," Policy Research Working Paper 5742, The World Bank, July 2011, 11.

[134] Terry Lynn Karl, "Oil-Led Development: Social, Political, and Economic Consequences," in *Encyclopedia of Energy*, Vol. 4, ed. Cutler J. Cleveland (Boston: Elsevier, 2004), 662.

Another strand of the curse's outcomes centers on governments themselves. Many authors cite the lack of taxation in oil states as a direct link to an absence of representation, which in turn enables autocratic rule. This type of domineering governance combines with minimal inroads for democracy to create societies that are politically repressed or prone to increased rates of violent political dissent or even civil war.[135]

Karl argues that commodity dependence shapes the state's institutions and decision frameworks, and that oil booms weaken state capacity by shifting attention and energy to allocation rather than extraction.[136] Once a bust occurs, the state is less able to adapt to operating with reduced resources to meet the expectations and commitments established when prices were high. Establishing patronage networks is politically expedient for ruling regimes, since they too reduce the likelihood of political dissent[137]; however, beneficiaries expect to receive benefits regardless of macroeconomic conditions.

Corruption, income inequality and subjugation of women are key societal outcomes.[138] The first two outcomes exist in conjunction with oil rents due to the absence of transparency.[139] Ross argues that through either subsidies or Dutch Disease, fewer women seek work or fewer jobs exist, resulting in a low participation rate in the labor force, which ultimately reduces female political power.[140]

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135 Ross, *The Oil Curse*, 6.

136 Terry Lynn Karl, *The Paradox of Plenty* (Berkeley: University of California Press, 1997), 7, 16.

137 Karl, "Oil-Led Development," 668.

138 Ross, *The Oil Curse*, 5–7; Frederick van der Ploeg, "Natural Resources: Curse or Blessing?" Journal of Economic Literature 49, no. 2 (2011), 386, http://www.jstor.org/stable/23071620?seq=1#page_scan_tab_contents.

139 Terry Lynn Karl, "Ensuring Fairness: The Case for a Transparent Fiscal Social Contract" in *Escaping the Resource Curse*, ed. Macartan Humphreys, Jeffrey Sachs, and Joseph Stiglitz (New York: Columbia University Press, 2007), 258.

140 Ross, *The Oil Curse*, 118.

b. Economic

Some portions of the literature cite the Dutch Disease as a cause of the curse, while other authors view it as an outcome. Another theoretical contributor is poor terms of regional and international trade. Additionally, weak connections between the enclaved hydrocarbon industry and the non-oil sectors restrain overall growth.[141] Pro-cyclical fiscal and monetary policies, where spending occurs in sync with oil prices, perpetuates state revenue booms and busts.[142] The patterns that the curse creates over time often translates into oil based governments having no realistic exit strategy to change the economy.[143]

One primary economic consequence is that exporters' growth routinely performs well below potential, given the possibility of returns on these countries' natural capital.[144] Frankel shows that growth averages have been lower for four decades in economies with high ratios of mineral rents to overall exports compared to a large number of low rent economies, shown in Figure 13. The volatile nature of oil revenue streams lead to unpredictable macroeconomic conditions, which creates difficulty managing the state's budget. Reliance on the state leads to bloated public-sector employment and high overall unemployment.[145] SOEs drive the economy, creating conditions that stunt private sector development and inhibit competitiveness.[146] Public investment programs that have the best intentions often sprawl out of control or do not achieve their desired objective.

141 Ross, "Political Economy of the Resource Curse," 298.

142 Jeffrey Frankel, "A Solution to Fiscal Procyclicality: The Structural Budget Institutions Pioneered by Chile," Working Paper 16945, National Bureau of Economic Research, April 2011, 11–13, http://www.nber.org/papers/w16945.pdf?new_window=1.

143 Jeffrey Sachs, "How to Handle the Macroeconomics of Oil Wealth," in *Escaping the Resource Curse*, ed. Macartan Humphreys, Jeffrey Sachs, and Joseph Stiglitz (New York: Columbia University Press, 2007), 194.

144 Humphreys, Sachs, Stiglitz, "Introduction: What Is the Problem with Natural Resource Wealth?" 4–6.

145 Al-Sheikh and Erbas, "The Oil Curse and Labor Markets," 3.

146 Steffen Hertog, "Public Industry as Tool of Rentier Economy Diversification: The GCC Case," in *Resources Blessed: Diversification and the Gulf Development Model*, ed. Giacomo Luciani (Berlin: Gerlach Press, 2012), 115–17.

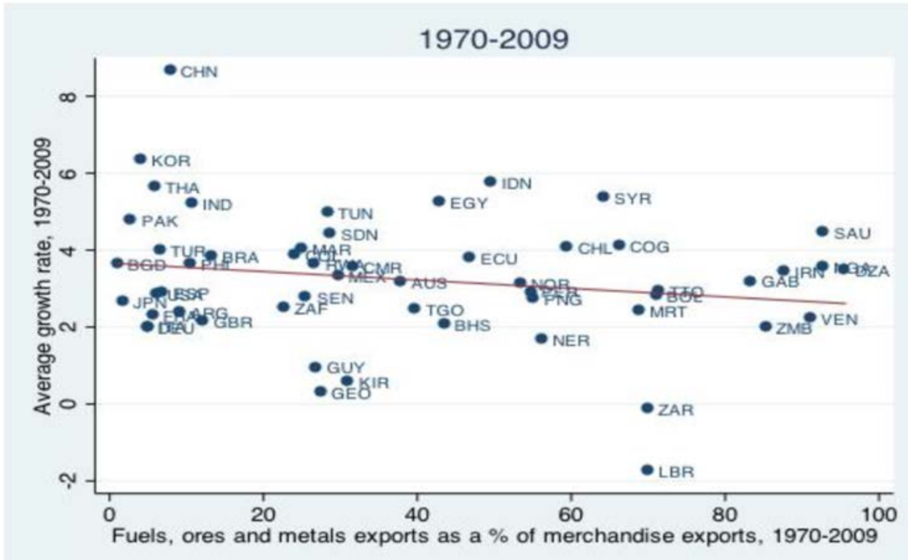

Figure 13. Statistical Relationship between Exports and Growth[147]

Discussion of the Dutch Disease permeates the literature. This condition is "A process whereby new discoveries or favorable price changes in one sector of the economy cause distress in other sectors."[148] Essentially high oil prices raise the real exchange rate, which makes non-tradable exports less competitive and leads to crowding out of other industries, usually agriculture or manufacturing.[149] Also, since the energy sector is so lucrative, it pulls labor away from other industries, even though hydrocarbon extraction and processing is not labor intensive.[150]

3. Escaping the Curse

The general sentiment in the prescriptive literature holds that since oil can be either a blessing or a curse, that a remedy exists to actually harness hydrocarbon revenues to underpin sustainable welfare programs and development, despite the history of

147 Source: Jeffrey Frankel, "The Natural Resource Curse: A Survey of Diagnoses and Some Prescriptions," RWP12-014, Harvard Kennedy School, April 2012, 3, https://dash.harvard.edu/bitstream/handle/1/8694932/RWP12-014_Frankel.pdf?sequence=1.

148 Karl, *Paradox of Plenty*, 5.

149 Humphreys, Sachs, and Stiglitz, "Introduction: What Is the Problem with Natural Resource Wealth?" 5–6.

150 Ibid.

underperformance among the aggregate of exporters.[151] Karl captures the essence of the way forward for remedying the issue at large: “The resource curse if fundamentally a political problem about the efficient, transparent, and just distribution of the costs and benefits from the world’s most valuable commodity. As such, it requires a political solution. This will not be easy.”[152]

a. Recommendations

Auty proposes a “dual track” approach, where geographically separate areas act as test beds that implement the desired outcomes first, which allows a gradual removal of rents from the overall structure of society in the second phase.[153] This technique allows elites that are accustomed to rent seeking to see the benefits of moving away from rent reliance, while simultaneously removing the threats to entrenched interests associated with reforms based on shock therapy timelines.

Many authors hold up transparency just under panacea status in solving many of the problems that plague oil states. The theory is that as internal operations become open to scrutiny, the likelihood of continued abuses of power that lead to corruption, rent seeking, inequality, etc., will diminish.[154] Given the centrality of transparency to combatting the curse, it is not surprising that while unveiling Vision 2030 MbS stressed the need for the Saudi oil sector to become more transparent, both to improve political, economic and social conditions, and also out of necessity, as Aramco’s IPO will provide investors access to information regarding the company’s profits and operations.[155]

A popular economic recommendation centers on the idea of saving today’s oil generated profits via investing them in funds that generate interest that future generations can employ as necessary. Some authors admit that this solution is unlikely to gain any ground without international pressure from non-state entities on ruling elites in exporting

151 Sachs, “How to Handle the Macroeconomics of Oil Wealth,” 174.

152 Karl, “Ensuring Fairness,” 277.

153 Auty, “The Oil Curse,” 345–46.

154 Karl, “Ensuring Fairness,” 258.

155 “Prince Mohammed bin Salman’s Al Arabiya Interview,” Al Arabiya.

countries, hence Auty's recommendation for a phased approach.[156] When leaders choose to invest oil wealth, they have four options for how to employ the state's funds: "oil in the ground, financial assets (e.g., foreign exchange reserves), physical assets (e.g., roads), and human capital (e.g., a better-educated labor force)."[157] A state's leadership should choose its investment mechanism based on its existing capital strengths and weaknesses.

In a similar vein, Frankel argues that counter-cyclical fiscal policy is necessary to offset the harmful effects of volatility.[158] Expanding expenditures during booms and contracting during busts only worsens the effects of these periods. Despite the example of some resource exporters, few countries have been able to implement this recommendation. One recommendation for the Saudi example that combines the benefits of counter-cyclical policies with the power of sovereign wealth funds is modifying the PIF by dividing it into "A Stabilization Fund and a Savings Fund."[159] Removing resources devoted to current spending from overall revenues can reduce dependence on oil for the annual budget, thus reducing the volatility associated with current accounts.[160]

b. Why Difficult

Effective solutions exist that point the way for developing countries to mitigate the effects of the oil curse, yet many states continue to bear the burdens of ineffective resource management. The obvious implication is that these economically sound policy recommendations are politically difficult in practice or unattractive to the government's leadership. Ignorance is not the overall culprit. In most cases, this disappointing trend likely stems from corruption, resistance to change, insufficient state capacity, or a combination of all of these factors.

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156 Hossein Askari, "Oil Rents, Political and Military Policies, and the Fallout: Implications for the MENA Oil Economies," in *Handbook of Oil Politics*, ed. Robert E. Looney (New York: Routledge, 2012), 188–89.

157 Sachs, "How to Handle the Macroeconomics of Oil Wealth," 192.

158 Frankel, "A Solution to Fiscal Procyclicality," 11–13.

159 Khalid A. Alsweilem, "A Stable and Efficient Fiscal Framework for Saudi Arabia: The Role of Sovereign Funds in Decoupling Spending from Oil Revenue and Creating a Permanent Source of Income," Harvard Belfer Center for Science and International Affairs, April 2015, 26, http://www.belfercenter.org/sites/default/files/legacy/files/Saudi.pdf.

160 Ibid.

C. THE OIL CURSE IN SAUDI ARABIA

The government has tried to diversify the economy and reduce the role of the state since the 1970s.[161] Many of the themes in Vision 2030 echo the priorities of the five-year development plans that shaped economic policy from 1970–2000. Somewhat ironically, the success of Vision 2030 depends on ARAMCO's pending partial IPO, whose advocates are seeking investors to support future oil production while the state plans to divest from its historic reliance on oil revenues.[162] Several aspects of the kingdom's oil sector separate it from the rest of OPEC and essentially the rest of the world's producers: it possesses the largest reserves, is the current swing producer, and it is the largest crude exporter.[163] New market dynamics are changing these conditions.

The kingdom suffers from several aspects of the oil curse, but some of the classic impacts do not apply to its experience. The country is ultimately better off for having large amounts of oil that drastically raised human development, unlike some producers in MENA, Africa, and South America. One method to classify oil's impact is to group exporters; the Legatum Prosperity index governance and economy rankings provide a useful benchmark.[164] Figure 14 shows the Legatum scores over time, placing Saudi Arabia in the oil blessing category, while its rival Iran suffers from a partial oil curse. Across the Red Sea, Sudan falls prey to the classic oil curse.

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[161] Niblock and Malik, *The Political Economy of Saudi Arabia*, 52–65.

[162] Simon Henderson, "Saudi Arabia's Vision 2030, One Year On."

[163] Ulrichsen, "Resource Security in Saudi Arabia," 175–80.

[164] Legatum Prosperity Index 2016, "Saudi Arabia Country Profile," Legatum Institute, http://www.prosperity.com/globe/saudi-arabia.

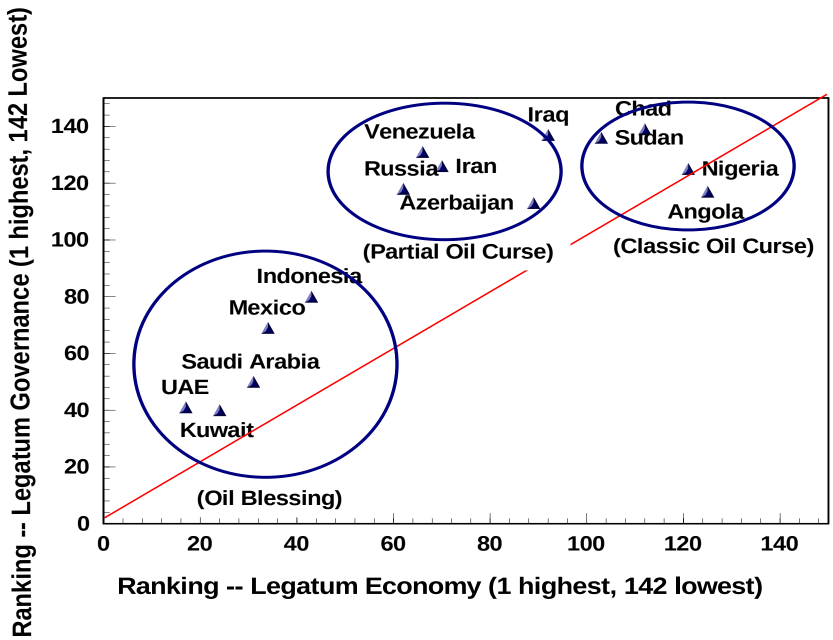

Figure 14. Oil Curse Groupings[165]

Saudi Arabia's overall Legatum rankings dropped in the past two years. Figure 15 shows the kingdom well beneath the index's prosperity gap, which balances these scores against PPP. This decline is primarily the result of the weaker macroeconomic environment associated with the period of reduced oil prices that began in 2014. The trend also reinforces the notion that even though oil has been an overall blessing, the dominance of rents and patronage on the Saudi system also created dependency and many complications. Repeated patterns of volatile economic performance produced sustained periods of weak growth, accompanied by steady state political conditions. The implication is that the existing model that developed since the first oil boom in 1973–74 is not sustainable without improved governance.[166] This dynamic supports the overall resource curse perspective that governance lies at the heart of the problem, even if a country does not fully experience all of the impacts of the curse.

[165] Source: Robert Looney, "The Saudi Arabian Model," in *Handbook of Emerging Economies*, ed. Robert E. Looney (New York: Routledge, 2014), 483.

[166] Ibid., 484.

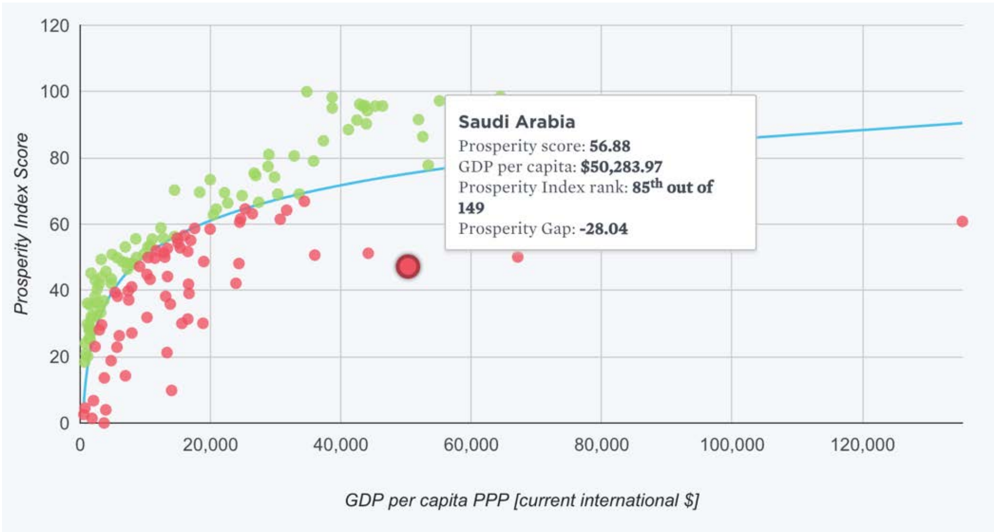

Figure 15. The Prosperity Gap[167]

1. Political

Some generalized rentier theories do not neatly fit into the Saudi experience once the level of analysis goes deeper than the state as a unitary actor. Hertog states "When Terry Lynn Karl argues that rentier states lack connections to their citizens, she seems to conflate macro, meso and micro."[168] Gause argues that Karl's claim that booms weaken petro-states fits the history of many countries but does not apply to Saudi Arabia.[169] His justification is that the Saudi state is able to effectively govern its society and the land within its borders, citing its capable ministries. The second part of this opinion is that political dissent in the kingdom occurred when oil prices were high, not low. Okruhlik's findings support Gause, as "Windfall profits of petroleum exports do not translate into a politically quiescent population."[170] The notion that political opinions have risen to the surface in the kingdom despite high rents, lack of representation, and even extremely low government tolerance for public political expression calls into question the standard view of rentierism in Saudi society.

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[167] Source: Legatum Prosperity Index 2016, "Saudi Arabia Country Profile," Legatum Institute, http://www.prosperity.com/globe/saudi-arabia.

[168] Hertog, *Princes, Brokers, and Bureaucrats*, 266.

[169] Gause, "Oil and Political Mobilization in Saudi Arabia," 14–19.

[170] Okruhlik, "Rentier Wealth," 295.

a. Governance and Capacity

The World Bank's governance index evaluates countries by six criteria. Figure 16 show that Saudi Arabia scores well on four of these, while its political stability is unimpressive and its voice is one of the world's lowest. Comparing the kingdom's governance scores to South Korea and China gives context. While the political systems in these three countries are very different, China and South Korea sustained world class average GDP growth over the last four decades. South Korea significantly outperforms both Saudi Arabia and China on all six topics. Saudi Arabia scores better than China in four categories, while China does better than KSA in government effectiveness; voice and accountability is a tie.[171] The inference is that governance has a direct impact on economic growth, but growth is ultimately the product of multiple factors. Figure 17 indicates that GCC regulatory quality is substandard compared to these oil states' economic performance. While regulatory quality is only one measure of overall governance, Saudi Arabia's average global score shows that it lags behind its Gulf neighbors, which highlights the lack of political reform that has accompanied previous attempts to modify the structure of the economy.

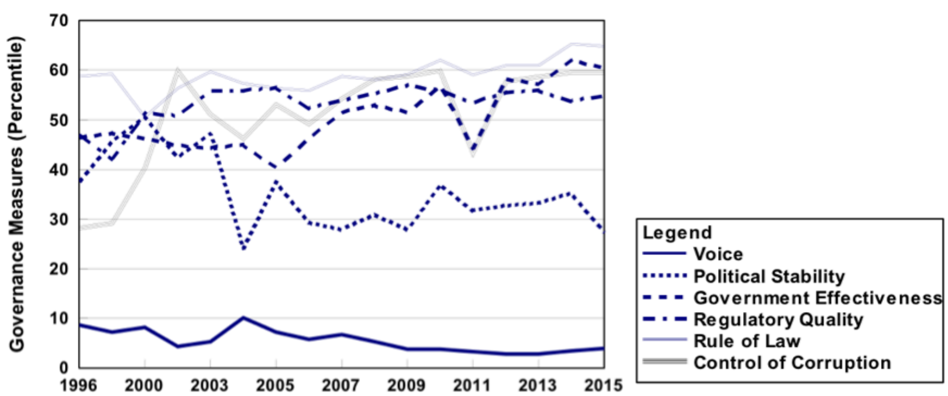

Figure 16. KSA Governance Indicators[172]

[171] "Worldwide Governance Indicators," The World Bank, Accessed August 22, 2017, http://info.worldbank.org/governance/wgi/index.aspx#reports.

[172] Source: Robert Looney, "Cammett: Chapter 3 Political Regimes in the Middle East," NS4053 Course Lecture, Slide 11, http://www.relooney.com/NS4053-Presentations-Spring-2017.html.

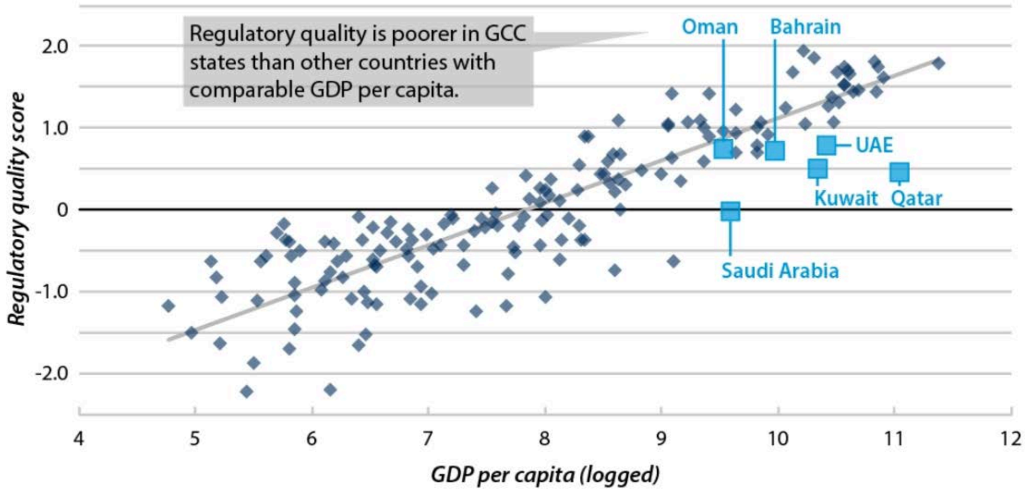

Figure 17. GCC Regulatory Quality in International Comparison[173]

Another way to separate oil producers is by rents per capita. Elbadawi argues that $2,000 is the threshold that qualifies a country as having high rents per capita, which separates those that suffer from many of the social aspects of the resource curse, in addition to some of the political problems, noted in Figure 18. He notes that Libya is the outlier to this trend. Compared to the rest of MENA, Saudi Arabia's location within the RRLP group is more politically stable and relatively economically sound compared to the RPLA countries, and even RRLA states. The kingdom provides support to several of the region's poorest members and to allies at risk from internal strife. Cammett notes, "While it is hard to believe that Saudi or UAE citizens would be richer in the absence of oil, it is more plausible to think that Iraq (or Nigeria) could have been better off without it."[174]

[173] Source: "Gulf States: Privatisation Will Face Obstacles," Oxford Analytica Daily Brief Service, September 14, 2016, http://libproxy.nps.edu/login?url=https://search.proquest.com/docview/1819136227?accountid=12702.

[174] Cammett, *A Political Economy of the Middle East*, 332.

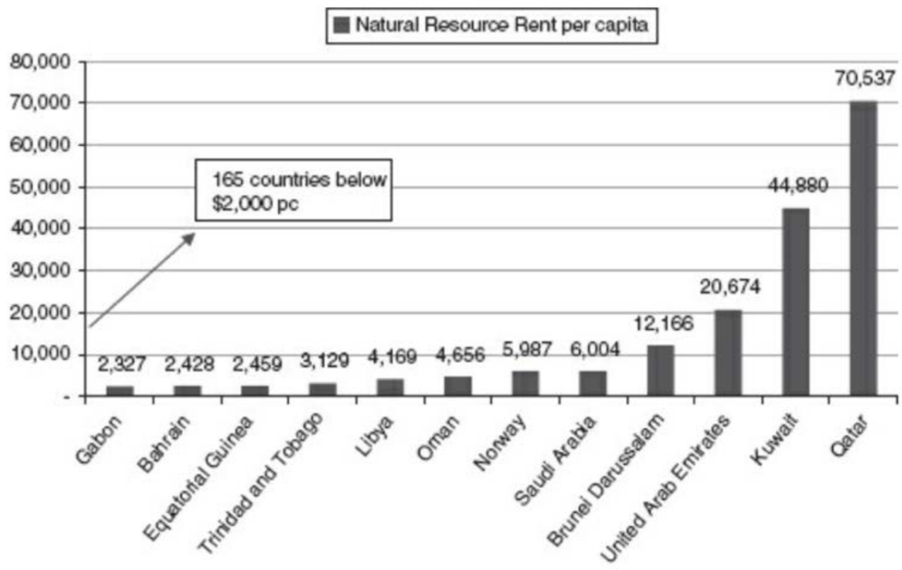

Figure 18. Resource Rents per Capita across Countries[175]

b. Outcomes

Saudi Arabia is by design one of the world's opaquest countries. Despite providing little insight into political calculus or Aramco's revenue streams, the kingdom is 62nd on Transparency International's Corruption Perceptions index.[176] This rank is lower than in previous years, although this is due to improvements that other countries made. Nonetheless, one would expect a much lower rank due to the association of rentier states with corruption. Other oil exporters fall much farther down the list, with Mexico coming in at 123rd, Iran at 131st, and Venezuela at 166th. Income inequality is problematic. Figure 19 outlines the likely flow of oil revenues through the government. The government has decided that they are willing to open up such details following Aramco's IPO to acquire cash and support diversification; it is unclear if similar types of information will become public knowledge in the effort to promote transparency.

175 Source: Ibrahim Ahmed Elbadawi, "Thresholds Matter: Resource Abundance, Development and Democratic Transition in the Arab World," in *The Middle East Economies in Time of Transition*, ed. Ishac Diwan and Ahmed Galal (London: Palgrave Macmillan, 2016), 215.

176 Transparency International, "Corruption Perceptions Index 2016," https://www.transparency.org/news/feature/corruption_perceptions_index_2016#table.

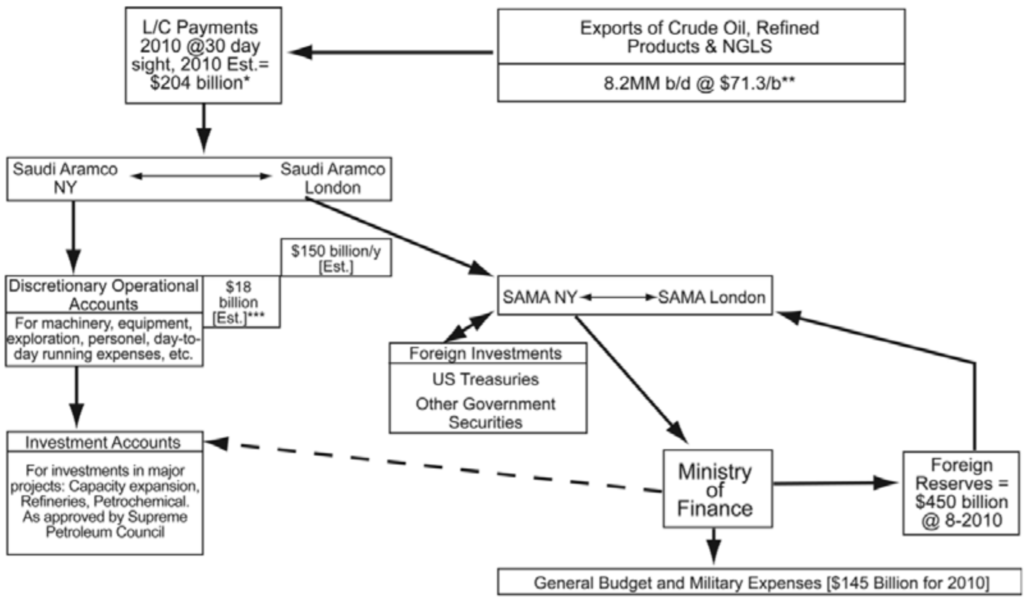

Figure 19. Possible Money Flows in Saudi Oil Transactions, 2010[177]

Despite the vast wealth available within the country, many citizens struggle to afford housing and millions of people live below the poverty line.[178] Women's equality is quite low, with the infamous driving ban still in effect; however, more Saudi women now graduate from universities than men.[179] Vision 2030 needs to create opportunities for the poor, youth, and women to manage expectations of these large, marginalized portions of the population.

Oil has greatly benefited the country in several important ways. Saudi scores on the UN's Human Development Index rose over the last 25 years, shown in Figure 20, improving the quality of life for the average citizen. Similarly, oil wealth enabled significant physical and critical infrastructure modernization. Political violence does exist, although the country is immensely more stable than many other MENA states.

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[177] Source: Jean-François Seznec, "Politics of Oil Supply: National Oil Companies vs. International Oil Companies," in *Handbook of Oil Politics*, ed. Robert E. Looney (New York: Routledge, 2012), 48.

[178] Kevin Sullivan, "In Saudi Arabia, Unemployment and Booming Population Drive Growing Poverty," Washington Post, December 3, 2012, https://www.washingtonpost.com/.

[179] "More Women Than Men in Saudi Universities, Says Ministry," Al Arabiya, May 28, 2015, https://english.alarabiya.net/en/perspective/features/2015/05/28/More-women-than-men-in-Saudi-universities-says-ministry.html.

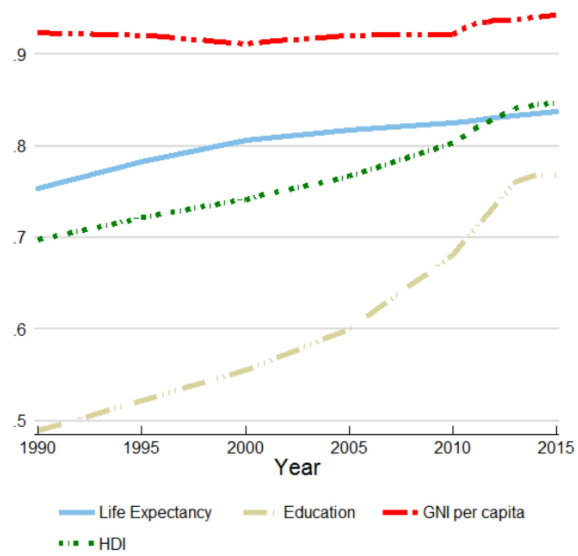

Figure 20. Trends in Saudi Arabia's HDI Component Indices' Values[180]

2. Economic

Saudi Arabia is a high-income country, since its GNI per capita exceeds $12,236.[181] The Heritage Foundation's Economic Freedom index classifies the kingdom as an emerging economy that is moderately free, ranking it 64th globally, just above the MENA and world averages.[182] Per the Heritage perspective, trade freedom and tax policy are current strengths, while government integrity, investment freedom, and financial freedom are problems.

a. Growth Theory

The neo-classical growth theory asserts that growth is a function of its inputs: capital, labor, and total factor productivity (TFP), which reflects efficiency.[183] Since the energy sector that dominates the Saudi economy is capital intensive and does not create

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180 Source: United Nations Development Program, "Human Development Report 2016: Saudi Arabia," UNDP, 3, http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/SAU.pdf.

181 "World Bank Country and Lending Groups," The World Bank, Accessed August 22, 2017, https://datahelpdesk.worldbank.org/knowledgebase/articles/906519.

182 Terry Miller and Anthony B. Kim, "2017 Index of Economic Freedom," Heritage Foundation, 330–31, http://www.heritage.org/index/pdf/2017/book/index_2017.pdf.

183 "Neoclassical Growth Theory," Investopedia, Accessed August 22, 2017, http://www.investopedia.com/terms/n/neoclassical-growth-theory.asp.

many jobs, the positive growth stabilization patterns that are needed to successfully diversify the economy away from oil must increase the role of TFP and labor.[184] TFP rates hover essentially at zero, which is problematic, yet also an opportunity that the country can and must seize. While human capital improvements are taking root, increases of capital and labor to overall output are not likely.[185] The World Bank's Growth Report's examination of the 13 economies that grew at seven percent or greater after World War II until 2000 finds that governments must pay attention to 16 areas of governance and economic policy to create competitive growth environments.[186] While there is no magic recipe that universally guarantees growth, Saudi economic policy matches several of the report's "bad ideas," specifically subsidizing energy, using the public sector to combat unemployment, and inhibiting competition for chosen economic sectors, (i.e., construction or downstream oil production in the Saudi case).[187]

Three broad policies dominated the Middle East in the latter half of the 20th century, prior to 21st century attempts to center the regions' economies on exports.[188] Saudi Arabia's economic history generally follows these trends. State led development shaped the 1970s, while Import Substitution Industrialization (ISI) dominated development strategies in the 1980s as Middle Eastern states strove to catch up with the industrialized world. The approach failed, earning this time period the title of the "Lost Decade."[189] The 1990s brought structural adjustment in an attempt to rectify the fiscal damage done in the 1980s. Cammett notes that the painful process did resolve many of the restraints on growth, although some problems persist.

Rostow pioneered growth stage theory to examine how changes to an economy's composition over time resulted in its transition to improved performance and ultimately

184 Looney, "The Saudi Arabian Model," 480.

185 Ibid., 481.

186 The World Bank, "The Growth Report: Strategies for Sustained Growth and Inclusive Development," Commission on Growth and Development, 2008, vii, https://openknowledge.worldbank.org/bitstream/handle/10986/6507/449860PUB0Box3101OFFICIAL0USE0ONLY1.pdf.

187 The World Bank, "The Growth Report," 68.

188 Cammett *A Political Economy of the Middle East*, 40–55.

189 Ibid., 159.

high-income status.[190] More recent constructions founded on this notion argue that growth occurs in three stages: "factor-driven, investment-driven, and innovation-driven."[191] Bremer and Kasarda expound on this concept to create three development phases shown in Figure 21: First, Middle, and Advanced. Saudi Arabia's lack of diversification and associated rent seeking has kept them at the beginning of the First phase. Per this theory, if the kingdom can incorporate the manufacturing programs outlined in the NTP the country will move into the Middle phase. Improving governance must go hand in hand with existing Saudi efforts to create a knowledge based economy in order to push into the Advanced phase.

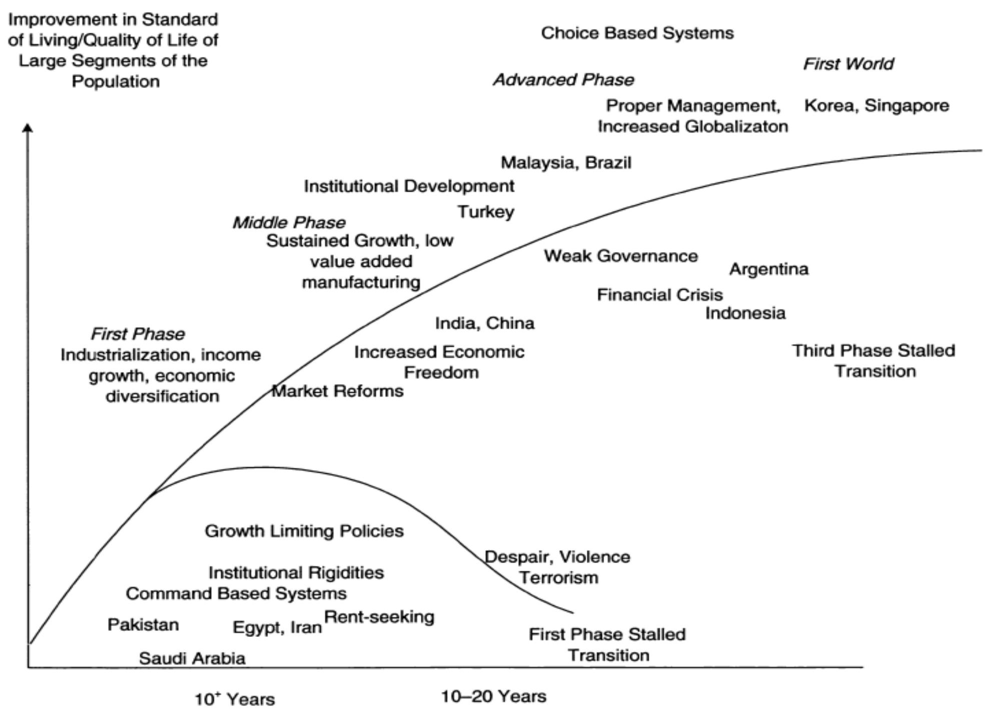


Figure 21. Bremer/Kasarda Stage Theory[192]

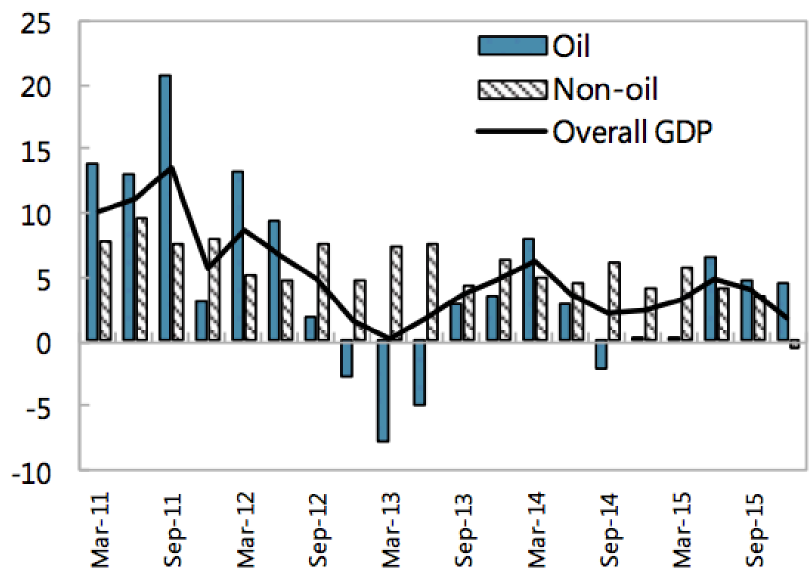
[190] W. W. Rostow, "The Stages of Economic Growth," *The Economic History Review* 12, no. 1 (1959), 1–16, http://www.jstor.org.libproxy.nps.edu/stable/2591077?seq=1#page_scan_tab_contents.

[191] Michael Porter, "Enhancing the Microeconomic Foundations of Prosperity: The Current Competitiveness Index," Harvard Business School, 7–8, http://www.relooney.com/NS3040/Porter.pdf.

[192] Source: Robert Looney, "Modern stage theories and their relevance for the emerging economies," in *Handbook of Emerging Economies*, ed. Robert E. Looney (New York: Routledge, 2014), 140.

b. *KSA's Performance*

Saudi Arabia's volatile GDP growth and GDP per capita growth since the late 1970s has typically fluctuated between 0 percent and 10 percent, although the oil booms and busts in the 1970s and 1980s created dramatic rises and falls in GDP, shown in Figures 22 and 23. Current accounts also reflect international oil prices, as evidenced by drops in 2009 and 2014 per Figure 24. Convergence theory argues that incomes of citizens in developing countries should catch up to those of the developed world over time, but this has not been Saudi Arabia's experience.[193] Many studies are quick to point out that Saudi GDP per capita remains essentially unchanged from the levels of income in 1970, which highlights the underperformance that the oil curse literature assigns to oil producers.[194]



Year on year percent change

Figure 22. Real GDP Growth[195]

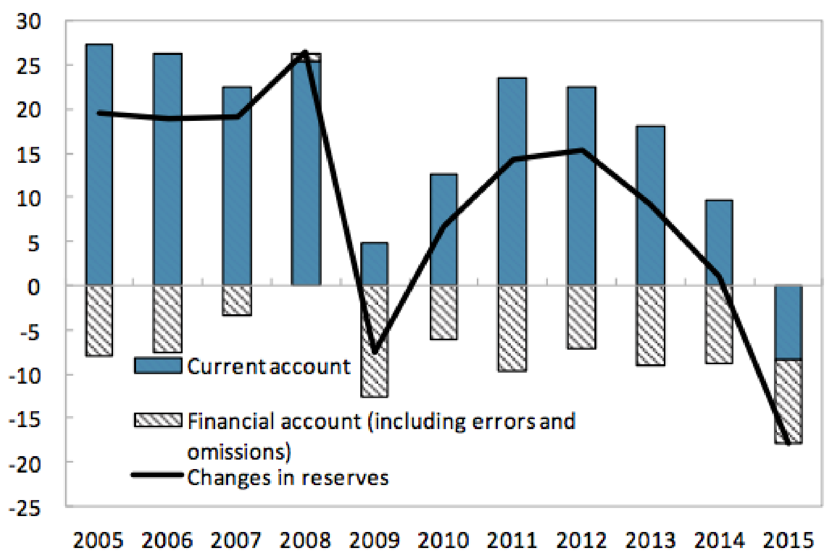
[193] Ali Al-Sadiq, "Economic Convergence in Saudi Arabia," International Monetary Fund, October 2014, 153, http://www.relooney.com/NS4053/00_NS4053_68.pdf.

[194] Ibid., 157.

[195] Source: IMF Staff, "2016 Article IV Consultation," 5.

Annual percent

Figure 23. GDP per Capita Growth[196]



Percent GDP

Figure 24. Current Account and Financial Account Balance[197]

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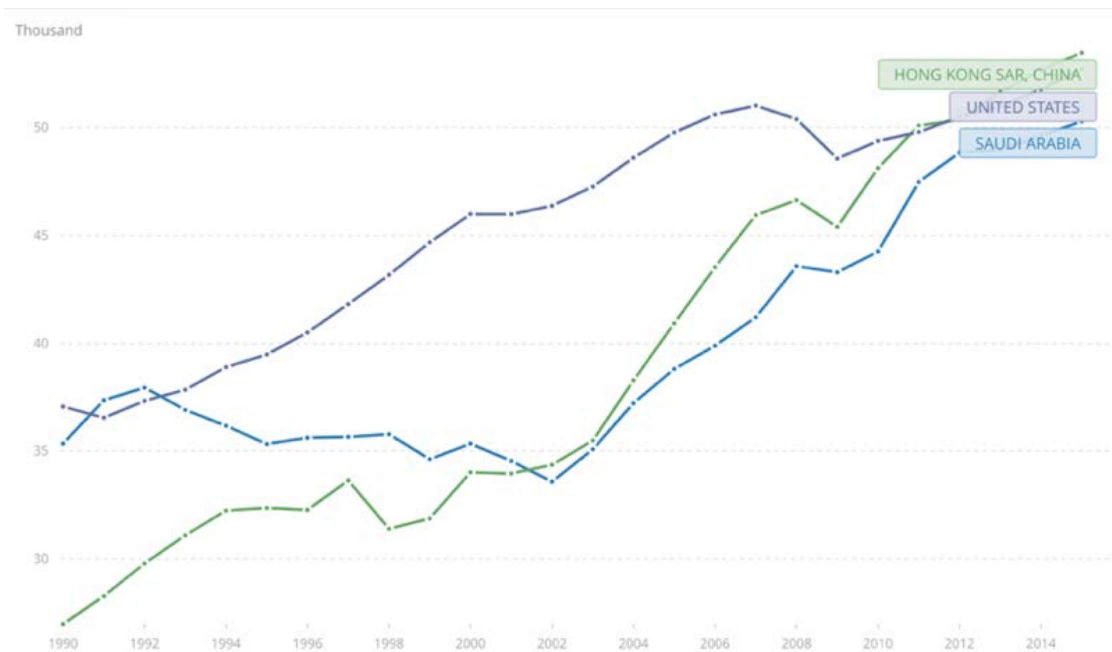
196 Source: "GDP per capita growth," The World Bank, Accessed August 22, 2017, http://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG?locations=SA.

197 Source: IMF Staff, "2016 Article IV Consultation," 5.

GDP per capita in terms of PPP in 2015 was just over $50,000.[198] This amount is approximately $2,500 less than PPP in the United Sates and $3,000 less than Hong Kong per Figure 25. This dynamic shows the impacts of low oil prices in the 1990s and higher prices after 2002 on individual citizens. Some argue that the lack of income convergence is a result of policies that tie the non-oil sector to government spending, which ultimately means that oil prices pervade all economic activity.[199]



Constant 2011 international $

Figure 25. GDP per Capita, PPP[200]

198 "GDP per capita, PPP (constant 2011 international $)," The World Bank, Accessed August 22, 2017, http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD?end=2015&locations=SA&start=1968&view=chart.

199 Al-Sadiq, "Economic Convergence in Saudi Arabia," 157.

200 Source: "GDP per capita, PPP (constant 2011 international $)," The World Bank, Accessed August 22, 2017, http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD?contextual=default&end=2015&locations=SA-HK-US&start=1990&view=chart.

The impacts of Dutch Disease are mixed. Manufacturing existed at the time of the first oil boom, but production primarily supported ISI.[201] So the oil curse did not crowd out manufacturing and agriculture sectors per se. Manufacturing has grown, albeit more in oil-related industries than non-oil. The lack of diversification outside of the energy sector since their establishment is influenced by the dominance of the oil sector. Agriculture exports have essentially been a failure.[202] This outcome is mainly due to a lack of comparative advantage. Most of Saudi Arabia is not a naturally suitable environment to grow wheat or raise dairy cattle. The government pegged the Saudi Riyal to the dollar almost 30 years ago, maintaining a 3.75 SR:1 USD ratio; despite the benefits of doing so, the riyal's value increased 17 percent since 2014.[203]

D. KSA'S ESCAPE ATTEMPTS

Economic modernization efforts across the GCC at large tend to fit into a common development model that rests on three primary pillars: "Hydrocarbon value added and energy intensive processing, logistics/services, and financial investments/ services."[204] Saudi Arabia is a leader in energy related manufacturing. SABIC is the world's second largest chemical producer. Initiatives designed to create a robust financial sector have yet to materialize, highlighted by King Abdullah Financial District's (KAFD) lackluster ability to attract international financial institutions.[205] Vision 2030 aspires to shift commercial maritime traffic flows into new port facilities, but major changes must occur before King Abdullah Port can rival Jebel Ali in Dubai.

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201 Cammett, *A Political Economy of the Middle East*, 55–60.

202 Ibid., 215.

203 George Abed, "The Saudi Riyal/Dollar Peg: Time for a Change?" *Financial Times* (blog), January 30, 2017, http://blogs.ft.com/beyond-brics/2017/01/30/the-saudi-riyaldollar-peg-time-for-a-change/.

204 Robert Springborg, "GCC Countries as "Rentier States" Revisited / Review Article by Robert Springborg," *Middle East Journal* 67, no. 2 (Spring 2013), 306, http://hdl.handle.net/10945/43323.

205 Angus McDowall, "Saudi Arabia Aims to Salvage White Elephant Financial District," Reuters, May 17, 2016, http://www.reuters.com/article/us-saudi-financialdistrict-idUSKCN0Y817U.

The history of reform programs in Saudi Arabia dates to the 1960s,[206] but traditionally such efforts did not tackle core problems,[207] since "'Doing very little' is the bane of all Saudi reform efforts."[208] This inefficiency stems partly from limited capacity for change that patronage imposes on the social construct, and also from the desire of elites to implement change slowly in order to manage the process and maintain their positions of power, authority, and wealth.[209]

Beginning in 1970, five-year development plans guided the budget for infrastructure, education, public services, labor policies, etc.[210] The plans were effective at allocating the physical capital needed to modernize the country's infrastructure. These initiatives were the mechanism through which the state improved standards of living that lead all geographic regions of the developing world. Many of the development plans initiated the diversification and privatization efforts found in Vision 2030 in the 1990s, with particular attention given to the economic cities and downstream petrochemical production. Some efforts were made to move the engines of the economy away from the state, (e.g., making SABIC a public private partnership that is 70 percent state held). While achieving moderate success, these efforts did not take root on the whole.

1. Policies

Reduction of the country's reliance on oil revenues centers on diversifying the economy into other productive sectors, privatizing state-owned activity and public support to reduce the state's fiscal burden, and creating jobs in the private sector for Saudi citizens in order to support the privatization effort and to reduce high levels of unemployment.

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206 Gregory Gause, "Saudi Arabia in the New Middle East," Council Special Report No. 63, Council on Foreign Relations, December 23, 2011, 10, https://ebookcentral.proquest.com/lib/ebook-nps/detail.action?docID=3137484.

207 Jane Kinninmont, "Saudi Arabia Faces Its Future in Vision 2030 Reform Plan," Chatham House, April 29, 2016, https://www.chathamhouse.org/expert/comment/saudi-arabia-faces-its-future-vision-2030-reform-plan.

208 Gause, "Saudi Arabia at a Crossroads?"

209 Ibid.

210 Niblock, Saudi Arabia, 50.

a. Comparison to Washington Consensus

While Gulf diversification efforts have taken much advice from international financial institutions (IFI) and consultant firms whose views range from pragmatic to neoliberal, GCC members have ultimately crafted their own version of macroeconomic policy, shown in Table 1. Similarities exist in promoting conservative fiscal policies and trade that is more or less classified as free. Luciani argues that the differences with the Washington Consensus have reduced Dutch Disease effects, yet enabled the reliance on cheap, imported labor that has produced the national labor market distortions and associated unemployment that currently have no real end in sight.[211]

Table 1. Diverging Consensuses[212]

Policies	Washington	Gulf
Exchange rate	Floating	Pegged to $
Fiscal conservatism	Yes	Yes
Stabilization/accumulation fund	Yes	Not necessarily
Taxes	Yes	Minimal user fees
Openness to international trade	Yes	Yes
Openness to foreign investment	Yes	No
Infrastructure	Follow demand	Anticipate demand
Subsidies to agriculture	No	Yes
State investment in industry	No	Yes
Subsidies to industry	No	Yes
Preference for domestic transformation	No	Yes
Openness to immigration	No	Yes
Segmented labor markets	No	Yes

b. Diversification

Figure 26 shows that despite repeated initiatives to diversify the economy over the past four decades, the Saudi economy is the least diversified within the GCC. Wages in non-oil sectors pale in comparison to the hydrocarbon sector; however, despite the oil's massive contribution to the overall economy, Saudi non-oil industries are growing.[213]

211 Luciani, "The Resource Curse and the Gulf Development Challenge," 23–27.

212 Source: Luciani, "The Resource Curse and the Gulf Development Challenge," 25.

213 IMF Staff, "2016 Article IV Consultation," 31.

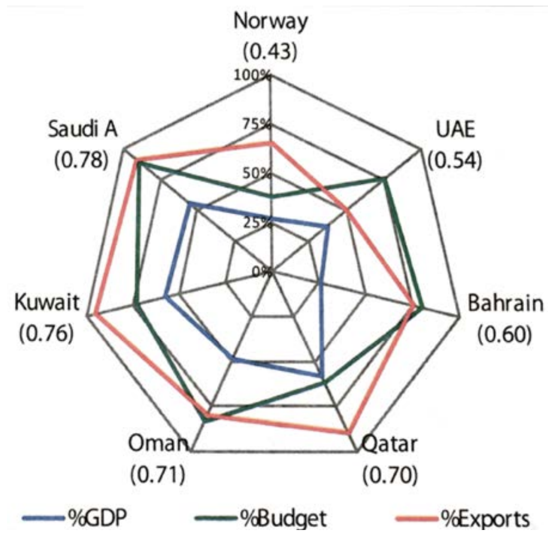

Figure 26. Degree of Diversification in the GCC[214]

Hans-Georg Mueller notes that "The scope for continued manufacturing diversification and productivity gains is determined to a large extent by the ability of the industrial sector to permanently restructure itself and shift resources from traditional, less productive sub-sectors to the technologically more advanced and more productive sectors."[215] Reliance on cheap foreign labor as a technological substitute harms innovation that is needed to expand the range of Saudi industries.[216]

Ali Aissaoui posits five policies that would optimize diversification efforts in Saudi Arabia: "Creating and maintaining a favorable and stable investment climate for enterprises; accelerating reforms of the educational and vocational training systems; providing an incentive structure that encourages competition and discourages rent-seeking behavior; integrating into the regional and global markets; and avoiding the detrimental effect of competition among the GCC countries."[217] Many opinions of

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[214] Source: Ali Aissaoui, "Saudi Arabia's Economic Diversification: Progress and Challenges in the Context of the GCC," in *Resources Blessed: Diversification and the Gulf Development Model*, ed. Giacomo Luciani (Berlin: Gerlach Press, 2012), 35.

[215] Hans-Georg Mueller, "GCC Industrial Development," in *Resources Blessed, in Resources Blessed: Diversification and the Gulf Development Model*, ed. Giacomo Luciani (Berlin: Gerlach Press, 2012), 175–76.

[216] Ibid., 179.

[217] Aissaoui, "Saudi Arabia's Economic Diversification," 87.

diversification attempts view these efforts as woefully unsuccessful.[218] Others see existing programs as proof that diversification is taking root.[219]

c. Privatization: Competitiveness

A primary distinction that must be made regarding the private sector in Saudi Arabia versus other countries is the role of the state within the private sector. The state needs to be involved to support the private sector's shift to export oriented production, yet it also needs to pull back from its previous levels of direct involvement in productive capacity. Chaudhry represents the view that individuals at the top of the private sector are tied to the state, and even constrained its development, thus implying that the private sector is not truly private.[220] On the other hand, Luciani represents the opinion that the private sector has grown more autonomous over time.[221] Hertog's analysis finds that policy decisions that govern the private sector are divided into "fiefdoms."[222] National ties to the private sector are segmented, which inhibits the overall efficiency of privatization by only partially implementing reforms in the sections of the bureaucracy whose leadership desires change.[223]

The state has aimed to reduce its role in the economy for several decades. While this action is needed, the perceived societal benefits and actual outcomes may differ depending on how this process plays out. Additionally, many of the industries where the government is planning to promote growth depend on the state's competitive advantage in cheap energy. Reliance on state supported, low cost feedstock in several sectors will keep the government directly involved in the private sector, thus eroding true privatization.

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[218] Toby Jones, "The Dogma of Development: Technopolitics and Power in Saudi Arabia," in *Saudi Arabia in Transition: Insights on Social, Political, Economic, and Religious Change*, ed. Bernard Haykel, Thomas Hegghammer, and Stéphane Lacroix (New York: Cambridge University Press, 2015), 32.

[219] Luciani, "Introduction: The Resource Curse and the Gulf Development Challenge," 27.

[220] Chaudhry, The Price of Wealth, 7; Hertog, Princes, Brokers, and Bureaucrats, 5, 39.

[221] Luciani, "Introduction: The Resource Curse and the Gulf Development Challenge," 4–9.

[222] Hertog, Princes, Brokers, and Bureaucrats, 14, 31.

[223] Niblock and Malik, The Political Economy of Saudi Arabia, 21–25.

Reducing the state's role in the economy via privatization is often touted as a necessary condition to improving fiscal sustainability. There is no question that some aspects of the Saudi economy need to move to the private sector, yet Figure 27 shows that after a closer look, privatization in and of itself may not necessarily solve all the problems that economists advertise.

Saudi Arabia benefits from the effective management of several of its key SOEs, but such success and profitability may create hesitation to let go of less well-run state corporations that would benefit from increased competition in the private sector. Hertog notes that SABIC and ARAMCO are among the GCC's "islands of efficiency," defying the global trend where state run corporations become bloated, inefficient, and even unprofitable.[224]

What privatization is supposed to offer	Barriers in the GCC
'State sector bad, private sector good'	Competition will not appear if the elites buy the enterprises; governments may sell as a monopoly, and large incumbents will inhibit new entrants
More effective incentives for management	'Government failure' will make it likely that exit will be messed up
Greater accountability forced on management	Governments will not allow strategic industries to fail
Reduced government interference, providing management with clear performance targets	Ineffective and inefficient capital markets are likely to be dominated by short-termism
Reduced financial constraints on management	Reduced government interference is unlikely: energy is a strategic sector, and there are objectives concerned with creating employment
	Serious price reform is needed
	Sell-off targets may be too large for domestic capital markets
	If only the ruling elites benefit, this will fuel unrest

Figure 27. Barriers to Effective Privatization in GCC States[225]

224 Hertog, "Public Industry as Tool of Rentier Economy Diversification," 115.

225 Source: Paul Stevens, "Economic Reform in the GCC: Privatization as a Panacea for Declining Oil Wealth?" Chatham House, December 2016, 12, https://www.chathamhouse.org/publication/economic-reform-gcc-privatization-panacea-declining-oil-wealth.

2. Programs

Three initiatives comprise the government's most significant initiatives to diversify, privatize, and re-employ citizens. Development of economic cities in conjunction with associated industrial parks specific to product clusters seeks to expand the range of manufacturing and to grow the number of business operating in the country. Selling off portions of SOEs allows the government to reduce its operating costs while retaining influence over the economy. Moving citizens from state to private employment is designed to reduce the state's fiscal burdens and create badly needed jobs.

a. Economic Cities and Industrial Clusters

Saudi leadership has placed significant amounts of financial and political capital into a new government agency, the National Industrial Cluster Development Program, in conjunction with economic, industrial, and educational cities.[226] The cluster program is the manifestation of an industrialization policy that strives to maximize comparative advantage and resource availability, specifically access to petroleum products and cheap energy. The clusters will complement existing downstream production capacity.[227] The five chosen export sectors that comprise the program are automotive production, minerals and metal processing, solar energy, pharmaceuticals and biotechnology, and plastics and packaging.[228]

The cities initiative has been in place since 1975, when the government established the Royal Commission for Jubail and Yanbu (RCJY) to lead the country's petrochemical efforts.[229] Since then the concept has taken root, as today there are

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226 Kingdom of Saudi Arabia. Industrial Clusters Program. http://www.ic.gov.sa.

227 Jean-François Seznec, "The End of Saudi Arabia's Addiction to Oil: Downstream Industrial Development," Atlantic Council, January 6, 2017, http://www.atlanticcouncil.org/publications/reports/the-end-of-saudi-arabia-s-addiction-to-oil.

228 S&P Global Market Intelligence, "Company Overview of National Industrial Clusters Development Program," Bloomberg, Accessed March 27, 2016, http://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=285002118.

229 Sultan Almasoud, "An Overview of the Industrial Sector in the Kingdom of Saudi Arabia and the National Industrial Cluster Development Program," Shearman & Sterling, LLP Client Publication, November 2016, http://documents.jdsupra.com/35e316d5-f7ce-4752-aac2-070755df0131.pdf; Kingdom of Saudi Arabia, "Industrial Clusters Program," http://www.ic.gov.sa.

approximately a dozen industrial cities throughout the country, plus several research and development cities, education cities, and economic cities. KAFD outside Riyadh has an unproductive track record to date, while the massively ambitious King Abdullah Economic City (KAEC), located 150 km north of Jeddah, is marketed as a capstone project that will encompass all aspects of the new industrial export program.[230]

One example of an initiative that intersects the privatization effort with economic diversification goals is the integration of solar energy into the national electrical grid. Vision 2030 calls for 9.5 GW of renewable energy by the year, an update to an earlier plan developed at King Abdullah City for Atomic and Renewable Energy (KA-CARE) that aimed to develop 41 GW of solar based electricity.[231] The incorporation of solar energy into electricity production is important to reduce domestic oil consumption, which costs the government approximately $70 billion annually in lost exports and threatens to consume all exports by due to projected rises in commercial and residential use.[232]

b. Public Private Partnerships (PPP)

The first experiment in partial privatization was selling 30 percent of SABIC in 1984, with approximately a dozen similar ventures taking shape since.[233] SABIC's success within the petrochemical industry is quite impressive, with total output that is second globally behind DOW Chemical.[234] SABIC and ARAMCO are both very well managed, while other SOEs are inefficient drags on the economy. A key question moving forward is how ARMACO will restructure itself following its 2018 IPO. If it can actually become an energy company, or perhaps an even broader holding company, its potential to drive growth is substantial.

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230 Lianna Brinded, "The Boss of Saudi Arabia's $95 Billion King Abdullah Economic City has 50 Meetings in 4 days to Attract Investors," Business Insider, January 22, 2016, http://www.businessinsider.com/king-abdullah-economic-city-kaec-fahd-al-rasheed-davos-interview-2016-1.

231 Philippe Chite and Ali Ahmad, "Solar Power in Saudi Arabia: Plans vs. Potential," American University of Beirut, Policy Brief #3, February 2017, https://www.aub.edu.lb/ifi/publications/Documents/policy_memos/2016-2017/20170222_ksa_solarpower.pdf.

232 Ulrichsen, "Resource Security in Saudi Arabia," 174.

233 "About Us," SABIC, Accessed August 22, 2017, https://www.sabic.com/en/about.

234 Seznec, "The End of Saudi Arabia's Addiction to Oil," 4.

c. Saudization

Since the 1990s the government has tried to create more jobs for its citizens outside of state employment via top down regulations.[235] This is one of the most important areas for the state to manage, because, "Unless state policy can ensure that Saudi citizens gain employment within the burgeoning private sector, on a basis where it is economically beneficial for employers to provide them with this employment, successful industrialization could well be socially disruptive."[236] Shifting private sector jobs to private citizens will enable Saudis themselves to drive the economy, while simultaneously reducing the state's fiscal burdens. Despite the importance of making jobs for citizens, especially for youth and women, Saudization has not achieved its targets.

The government implemented several programs designed to force private sector businesses to hire citizens, (e.g., the Nitaqat initiative in 2011).[237] The overall effort to employ citizens outside the government's payroll notionally began in the 1940s, but the modern push to change labor market dynamics began during the fourth development plan in the mid 1980s.[238] The approach is a top down directive that has three key characteristics: quotas, job reservations, and training subsidies.[239] The policies have become more top down instead of market driven and do nothing to reduce wages to make Saudi labor more financially attractive to employers. The end result is often that companies find workarounds to skirt regulations or, in extreme cases, relocate to neighboring countries with more attractive labor policies.[240]

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[235] Ahmad Alghamedi, *Enhancing Employment Opportunities in the Saudi Arabian Private Sector* (Malibu, CA: Pepperdine University, 2016), 1–3.

[236] Niblock and Malik, The Political Economy of Saudi Arabia, 25.

[237] Alghamedi, Enhancing Employment Opportunities in the Saudi Arabian Private Sector, 1–5.

[238] Ådne Cappelen and Robin Choudhury, "The Future of the Saudi Arabian Economy: Possible Effects on the World Oil Market," in *Oil in the Gulf: Obstacles to Democracy and Development*, ed. Daniel Heradstveit and Helge Hveem (New York: Routledge, 2017), 47.

[239] Hertog, "Labor Market Nationalization Policies in the GCC," 91–93.

[240] Ulrichsen, "Resource Security in Saudi Arabia," 181.

E. SUMMARY

Oil shaped modern Saudi Arabia and will continue to play a major role in the country's future. The oil curse has partially manifested itself in the kingdom's politics, economy, and society. Large, opaque oil revenues furnished the monarchy with the ability to form patronage networks that enabled them to rule with a tight grasp on power. Rent seeking does occur, shaping political activities and impacting institutional quality. Average GDP growth is unimpressive given the size of the country's oil reserves. Economic inequality is a significant problem, and additional steps toward democracy are currently beyond citizens' reach. At the same time, oil revenues significantly raised living standards and enabled the establishment of other industries. Success stories include SABIC, while agriculture policies were incredibly inefficient.

Aspects of the curse, such as Dutch disease, are problematic in that oil has made other industries reliant on oil performance. That being said, other industries would not likely have come into existence without large oil revenues. The lack of transparency in the government has political and social ramifications that resemble some claims of the curse, such as female subjugation. Civil war and political upheaval is absent, unlike many countries that fall under the full oil curse.

The kingdom is ultimately better off with oil, but it cannot afford to remain dependent on crude exports in the future for a variety of economic reasons. Oil reliance created the labor market problems that the government desperately wants to rectify. The economy must create an adequate number and the right type of jobs for its young people if it has any hope of making this change. New approaches are needed to make a local labor force that can compete on the world stage.

The partial presence of the oil curse in KSA is sufficient to make the economy struggle to make meaningful economic changes so long as existing governance models remain in place. MbS' succession increases the likelihood that reform initiatives will continue to receive support, but does the new power dynamic indicate that a benevolent autocracy will emerge if and when MbS becomes king? Saudi approaches to fixing the economy stem from the position of retaining government control of industries or bringing glory to the ruling family. Such attempts have not stemmed from a meaningful campaign to reduce the oil curse because the underlying political conditions persist. Economic reform cannot occur in isolation.

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IV. MARKET INEFFICIENCIES

A. INTRODUCTION

The ability to switch the Saudi economy to a new model depends on how well it can compete in international markets outside of the oil sector. Even if sufficient political change occurs to meet the goals in Vision 2030's programs, the private sector has to be able to sell its products to flourish. Two of the most important underlying factors that determine competitiveness are the quality of the business environment and human capital.

Opportunities exist for the government to change the conditions that shape how Saudi firms hire employees, whom they employ, how students' education prepares them for their careers, and how citizens view private sector employment. An example of improving institutional quality is a set of new regulations that are making FDI a more streamlined process.[241] Nonetheless, if the state does not seize these opportunities, old habits will endure and remain stumbling blocks to competitive progress.

Institutional support for private growth requires expansion. In most industrialized states, the private sector can flourish because it is built upon a foundation that ensures favorable conditions. Such systems protect property rights, enforce contracts, enable fairness for competition, provide access to credit, ensure bankruptcy policies exist, etc. The government is striving to increase confidence in such conditions by sending its ministers to promote the country.[242] Saudi citizens and foreign investors currently have cause for hesitation in growing a business, taking risk or placing capital in the private sector, since opinions vary on the quality of the kingdom's objective, rule based processes.

Many Saudi university graduates trained to work in the public sector since the bureaucracy is the employer of choice. Existing education curricula and job preparation

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[241] Michael Quigley, "SAGIA Simplifies FDI Process," Blakes Business Class, November 6, 2015, http://www.blakesbusinessclass.com/sagia-simplifies-fdi-process/; "Saudi Arabia - 1-Openness to and Restriction on Foreign Investment," International Trade Administration, July 19, 2017, https://www.export.gov/article?id=Saudi-Arabia-openness-to-foreign-investment.

[242] World Economic Forum, "Davos 2017 - Saudi Arabia Vision 2030," YouTube video, World Economic Forum, January 19, 2017, https://www.youtube.com/watch?v=ef8fjnTFGGo.

programs are insufficient to produce an internationally competitive total workforce.[243] Top tier employees with experience at the hallmark public companies, (e.g., Aramco), are prepared to lead in private industry, but the majority of Saudi labor is calibrated to operate within the confines of state employment. Private sector revenues cannot replace those from the public sector overnight since the required workforce is not ready.

Women and youth comprise huge percentages of the population that is unemployed. Females make up just under half of the total population, while 45 percent of Saudis are under the age of 25 and 55 percent are under the age of 30.[244] Approximately a third of women do not work, while unemployment of 15–24 years olds hovers around 30 percent.[245] These groups represent untapped and essential resources to replace expatriate workers. Philosophically, ushering women into the workforce represents a change in Saudi identity, as does moving youth out of state subsidized lifestyles, whether via public sector jobs or unemployment benefits. The upcoming generation of Saudi workers will define its identity and priorities based on its impressions of Vision 2030.

B. BUSINESS ENVIRONMENT

The dynamics of Saudi Arabia's business environment and the quality of its institutions profoundly shape the range of options that policy makers have in their efforts to diversify and privatize the economy. While debates over appropriate levels of state intervention in an economy will endure in the political economy field, there is no question that the conditions that a government creates bear direct consequences on businesses. Since the Saudi state is an active participant in the country's mixed economy, its decisions carry more weight compared to capitalist systems.

Competitiveness is the summation of how well an economy fares on "Internal markets, external price, external cost, and measures of competitiveness based on growth

[243] Mary Sophia, "Saudi Arabia Needs to Provide Job Skills To Its Youth," Gulf Business, December 31, 2013, http://gulfbusiness.com/saudi-arabia-needs-to-provide-job-skills-to-its-youth/.

[244] "The World Factbook: Saudi Arabia," Central Intelligence Agency.

[245] IMF Staff, "2016 Article IV Consultation," 36; World Economic Forum, "Saudi Arabia Profile," Human Capital Report 2016.

fundamentals."[246] Saudi Arabia ranks 29th on the WEF's Global Competitiveness Index, outperforming the MENA average in every subcomponent of the economy, noted in Figure 28. The Competitive Index's first four pillars in blue are "basic requirements," while the next five pillars in green are "efficiency enhancers," and the last two pillars in red are "innovation and sophistication factors." Notable current weaknesses are the macroeconomic environment and labor market efficiency, with sub-index ranks of 68 and 65, while financial market development, higher education and training, business sophistication, and innovation are areas currently underdeveloped but primed for growth. The Competitiveness Index paints the rosiest picture of Saudi Arabia of all the studies cited in this paper. The WEF argues that diversification requires more sophisticated production and services, which entails workers who are employed more efficiently and with stronger STEM and management capacity.[247]

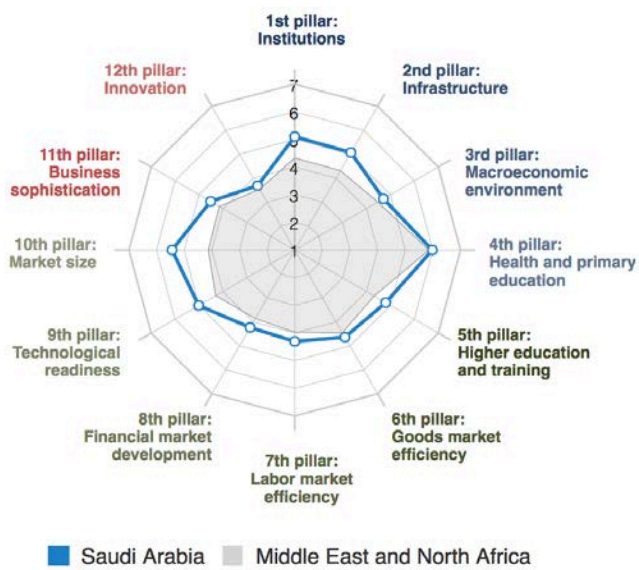


Figure 28. MENA Competitiveness Index[248]

[246] Kenneth Wilson, "How Competitive are Gulf Economies?" in *GCC Financial Markets: The World's New Money Centers*, ed. Eckart Woertz (Berlin: Gerlach Press, 2012), 259.

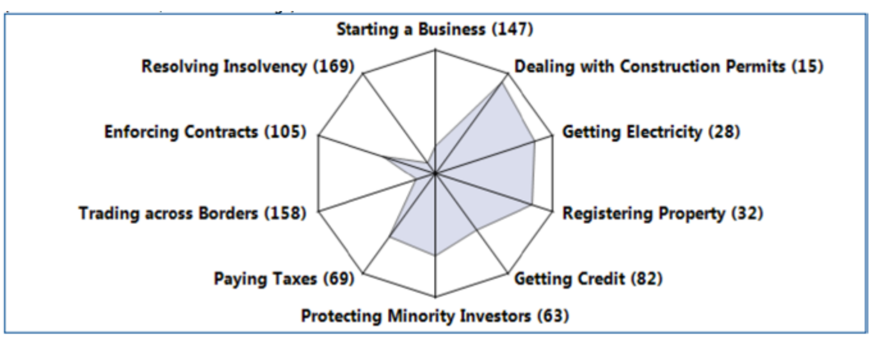
[247] World Economic Forum, "Saudi Arabia Profile," Global Competitiveness Index 2016, http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=SAU.

[248] Source: World Economic Forum, "Saudi Arabia Profile," Global Competitiveness Index 2016, http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=SAU.

1. Doing Business

Saudi Arabia ranks 94th of 190 countries on the World Bank's 2017 Doing Business index, up two positions from 2016.[249] This rank is well below UAE's position of 26th, and even Bahrain at 63rd, Oman at 66th, and Qatar at 83rd. The Saudi score of 61.11 is above the MENA score of 56.36 and Kuwait's rank of 102. Four subcategories are quite poor: starting a business, enforcing contracts, trade across borders, and resolving insolvency, per Figure 29. The low quality of enforcing contracts does not bode well for property rights. Resolving insolvency scores zero due to the current absence of bankruptcy laws, although Minister of Commerce and Investment al-Qasabi stated in April 2017 that this law will be signed later this year.[250]

Despite poor performance in four categories, ranks for the index's other six categories are positive, although none are stellar. The kingdom has the region's largest economy, but nearly half of the requirements necessary to participate in it are obstructive. The obvious implication is that the government needs to create better conditions if it truly desires to promote privatization.



Scale: Rank 190 Center, Rank 1 outer edge

Figure 29. Rankings on *Doing Business* Topics—Saudi Arabia[251]

[249] The World Bank, "Economy Rankings," Doing Business Project, http://www.doingbusiness.org/rankings.

[250] "Vision 2030: One Year into Saudi Arabia's Economic Reforms," YouTube video, Center for Strategic & International Studies, April 20, 2017, https://www.youtube.com/watch?v=sSZ4WvIc4LA.

[251] Source: The World Bank, "Saudi Arabia Economy Profile 2017," Doing Business Project, 9, 20, http://www.doingbusiness.org/~/media/wbg/doingbusiness/documents/profiles/country/sau.pdf.

Also from the Doing Business report are the factors that domestic business owners cite as their main problems, shown in Figure 30. "Restrictive labor regulations" and "Inadequately educated workforce" come out as the leading impediments from the managerial perspective, sentiments that echo the position of the Competitiveness Index. Corruption and employee work ethic are two often cited weaknesses of the Saudi system in the policy literature, yet these issues actually appear less problematic.[252]

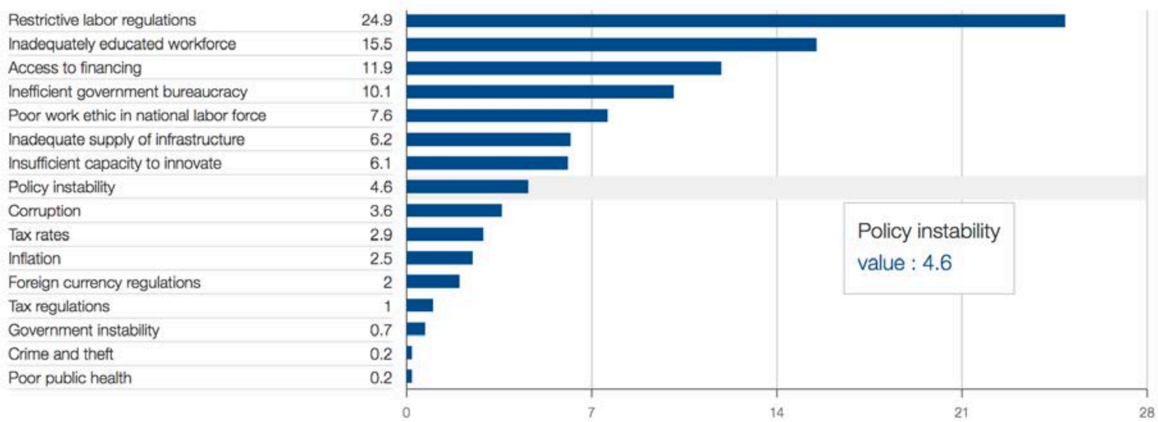


Figure 30. Most Problematic Factors for Doing Business[253]

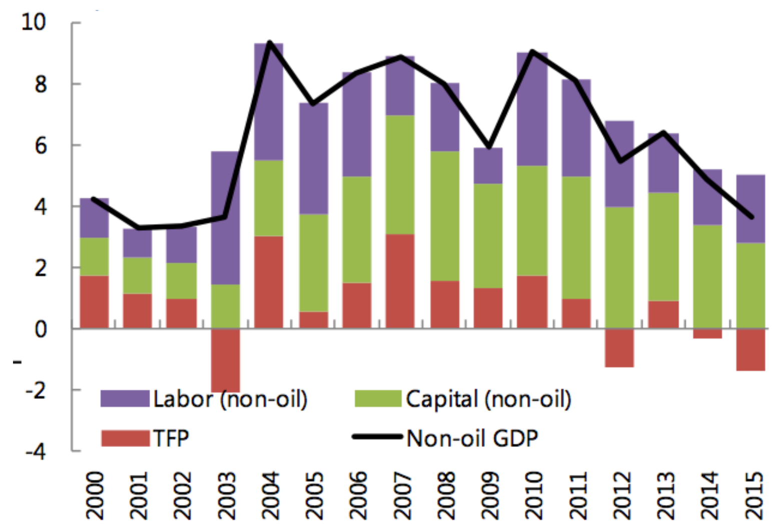
a. Efficiency

Total Factor Productivity (TFP), which measures efficiency of labor and capital, averaged 1.3 percent of overall non-oil growth from 2000–08 and 0.2 percent from 2009–15, highlighted in Figure 31. Substituting cheap labor for innovation and efficiency, plus high rates of capital, is a hallmark of the Gulf development model. Inefficiency has hampered growth and will continue to do so regardless of other reforms.[254]

[252] Robert Looney, "Saudi Arabia: Out of Options?"

[253] Source: World Economic Forum, "Saudi Arabia Profile," Global Competitiveness Index 2016, http://reports.weforum.org/global-competitiveness-index/country-profiles/#economy=SAU.

[254] Looney, "The Saudi Arabian Model," 480–82.



Percent

Figure 31. Growth Decomposition[255]

An example of how the institutional and business environments impact the country's ability to expand the private sector and to increase efficiency is the status of entrepreneurship. The Global Innovation index, which examines innovation input and output, ranks the kingdom 55th out of 127 countries.[256] Creating the right environment is simply the beginning of fostering an entrepreneurial spirit. Education and skilled labor are essential, but so is connectivity with the global market of ideas. Small and Medium Enterprises (SME) can drive private productivity from the ground up, but not under current conditions.[257] A "dual-track development strategy" that supports large firms and SMEs is an example of how the state can support the private sector to promote privatization.[258]

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[255] Source: IMF Staff, "Saudi Arabia: Selected Issues," International Monetary Fund, October 13, 2016, 59, http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Saudi-Arabia-Selected-Issues-44329.

[256] Cornell INSEAD WIPO, "Saudi Arabia Profile," Global Innovation Index 2017, https://www.globalinnovationindex.org/analysis-economy.

[257] Robert Looney, "Development Strategies for Saudi Arabia: Escaping the Rentier State Syndrome," *Strategic Insights* 3, no. 3 (March 2004), 1–5, https://www.hsdl.org/?view&did=444733.

[258] Ibid.

b. Institutional Quality

Several of the indices above and in Chapter III highlight that Saudi Arabia's institutional environment is a mixed picture, with poor performance in multiple areas, but also some surprises, (e.g., corruption). Rentier states often earn negative association with high levels of corruption, stemming from substandard rule of law, transparency, or property rights.[259] The narrative then assigns associated results such as income inequality, poor conditions to conduct business, or an inhospitable foreign investment climate. The scores of Saudi institutions that affect the business environment underpin the arguments presented in Chapter II that claim that Saudi Arabia does not fit all aspects of the stereotypical rentier state.

2. Industrial Constraints

Diversification in Saudi Arabia so far is a somewhat misleading term, given that industries used to replace crude oil exports still revolve around energy commodities themselves, (e.g., petrochemicals), or benefit from the region's competitive advantage of access to cheap feedstock or electricity.[260] The region's banks have become adept at financing petrochemical industrialization projects, and local stock markets are playing an increasing role in this process, but the cost of many of the newer initiatives is so large that individual institutions cannot fund such ventures on their own.[261] Luciani finds that industries that rely on large quantities of cheap electricity, (e.g., aluminum production), will prove more burdensome than downstream industries that simply rely on access to cheap oil and gas feedstock.[262]

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[259] Karl, "Oil-Led Development," 661, 666–69.

[260] Giacomo Luciani, "Domestic Pricing of Energy and Industrial Competition," in *Resources Blessed: Diversification and the Gulf Development Model*, ed. Giacomo Luciani (Berlin: Gerlach Press, 2012), 110–12.

[261] Jean-François Seznec, "Financing Industrialization in the Arab-Persian Gulf," in *Industrialization in the Gulf: A Socioeconomic Revolution*, ed. Jean-François Seznec and Mimi Kirk (New York: Routledge, 2011), 30–38.

[262] Luciani, "Domestic Pricing of Energy and Industrial Competition," 112.

a. Intra-GCC Competition

Many of the industries targeted to support diversification exist in other Gulf countries, so intra-GCC competition is a concern for the kingdom.[263] Opportunities to cooperate exist, for example integrating gas infrastructure, but little ground has been made. Plans to expand the Saudi transportation sector is an example of how hopes for the future can run into well-established operations, such as Dubai World. Growth industries for the GCC at large, specifically nuclear power, are already showing signs of progression with minimum coordination across international lines, seemingly creating a leadership contest between Saudi Arabia and the UAE in the same way that they have fought to represent the GCC common market.[264]

b. Industrialization Window

Saudi non-petrochemical manufacturing predominately consists of basic materials and food processing.[265] Efforts to increase TFP need to coincide with improvements in the sophistication of manufacturing. The country's leadership ultimately desires to create a knowledge economy, although attaining this ambition is farther off in the future than the ministers and MbS wish to admit.

Central to improvements in manufacturing is discovering where to find slack in the global economy. China will not be the world's factory forever as it is moves toward becoming a service economy. The question is whether or not the Saudi economy can absorb higher quality manufacturing before emerging competitors, (e.g., India), establish market share dominance.

C. HUMAN CAPITAL

The kingdom ranks 87th out of 130 countries on the World Economic Forum's Human Capital Index.[266] KSA ranks 9th of 15 within MENA and at the bottom of the

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[263] Aissaoui, "Saudi Arabia's Economic Diversification," 91.

[264] Ibid., 88–92.

[265] IMF Staff, "2016 Article IV Consultation," 31.

[266] World Economic Forum, "Saudi Arabia Profile," Human Capital Report 2016, http://reports.weforum.org/human-capital-report-2016/economies/#economy=SAU.

high-income countries on this list. Saudi youth aged 15–24 perform the best of any age bracket in the country. This group is internationally uncompetitive in the index's sub-categories of vocational enrollment rate, labor force participation rate, and unemployment rate, although they did score well on long-term unemployment rate and skill diversity.

1. Insufficient Skills

Saudi Arabia succeeds at providing nearly universal primary and secondary schooling, but it does an average job turning the education of its population into an employed labor force, per Figure 32. Irrespective of education type and quality, which are the primary areas that need attention in the Saudi education system, the chart indicates that Saudi citizens generate squarely middle of the road scores for maximizing their education.

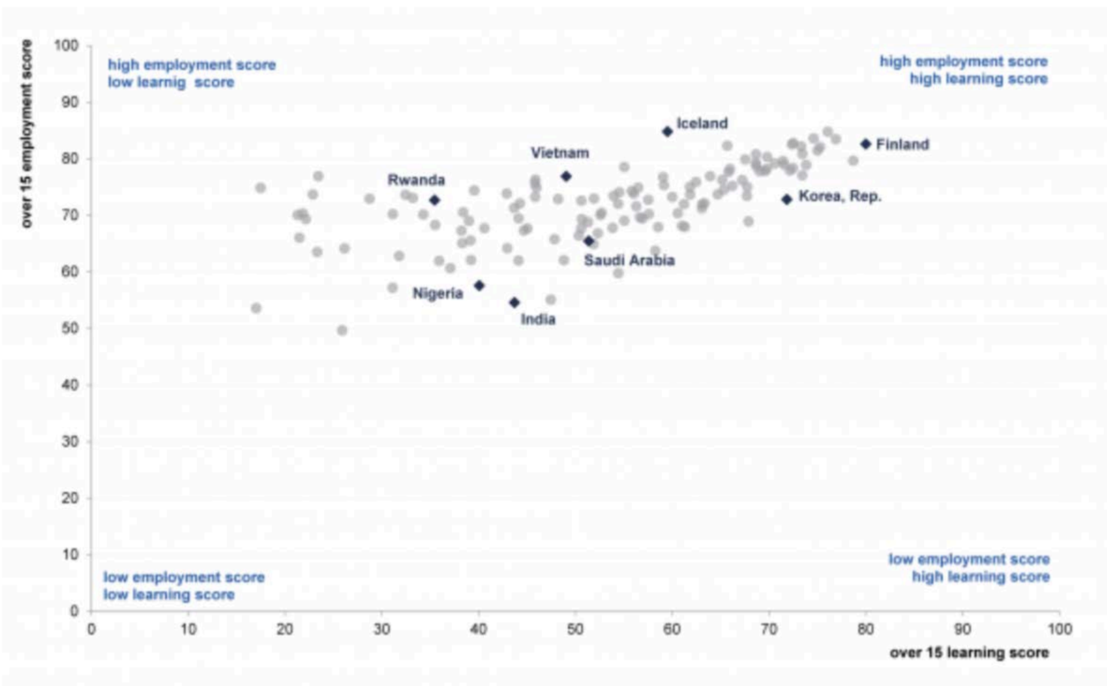

Figure 32. Education and Employment[267]

[267] Source: World Economic Forum, "Infographics and Shareables," Human Capital Report 2016, http://reports.weforum.org/human-capital-report-2016/infographics-and-shareables/.

The quality of the workforce has been an issue that has impacted the transition of citizens en masse to the private sector. Literacy and education enrollment rates are actually quite high, and surprisingly more women now graduate from college than men.[268] Modern academic institutions like King Abdullah University of Science and Technology (KAUST) are paving the way to the knowledge economy. The country has two education ministries, with primary and tertiary systems managed separately. Ironically, the country needs more skilled students who are prepared to competitively drive private sector growth while simultaneously needing private sector workers to fill blue collar positions. The income level per capita compared to the Human Capital index scores shows that Saudi workers are not living up to their potential, noted in Figure 33.

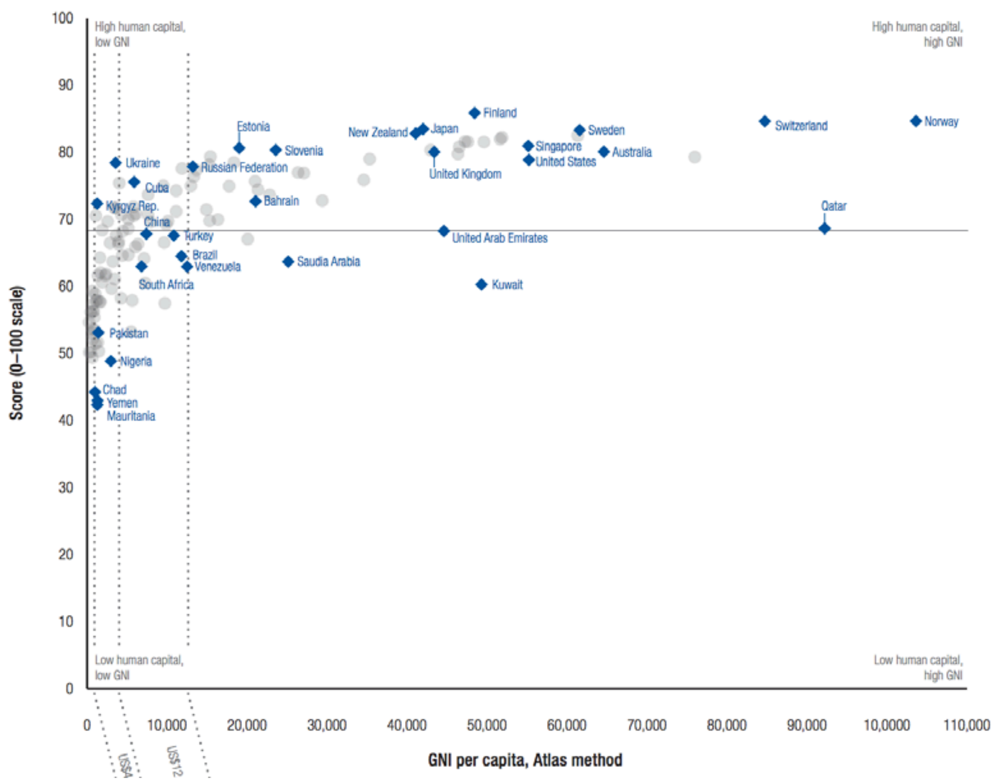

Figure 33. GNI Per Capita and Human Capital Index 2016[269]

268 “More Women Than Men in Saudi Universities, Says Ministry,” Al Arabiya.

269 Source: World Economic Forum, “The Human Capital Report 2016,” World Economic Forum, 12, http://www3.weforum.org/docs/HCR2016_Main_Report.pdf.

2. Labor Force Integration

Saudi citizens must join the private sector in record numbers for any of the ambitious plans to work. Several factors hamper creating the right type and number of jobs, which is arguably the most critical task facing the country. The failure to put citizens in manufacturing positions in the 1980s still hurts the economy, while formal requirements imposed on businesses that are designed to employ citizens have had little success because such initiatives are ultimately bad for business.

a. Demographic Dividend

Unlike the East Asian Tigers, Saudi Arabia and the GCC at large did not capitalize on its demographic dividend during the lost decade during the late 1980s.[270] This dividend describes the scenario in Korea, Singapore, Hong Kong and Taiwan where the growth of the labor force outpaced overall population growth, increasing GDP per capita. Cammett notes that population rise across MENA coincided with economic downturns, creating an underlying problem that has complicated job creation efforts for the past several decades and will continue to retard job growth for young Saudis. Khalid al Falih, Minister of Energy, Industry, and Mineral Resources, stated in various interviews that the government views the massive increase in young people entering the workforce as an asset that can interject energy and a new attitude into how the country conducts business.[271] Such optimism seems more of a political sales pitch geared to attract foreign investors than genuine belief, since the western literature almost unanimously views the youth bulge as a contributor to unemployment and a liability for the state that is poised to threaten the existing system.

b. Saudization

Saudization policies comprise efforts to force companies to hire locally, to restrict hiring foreigners in certain industries, and to subsidize training and initial employment. These attempts have struggled due to the labor price differences between Saudi and

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270 Cammett, *A Political Economy of the Middle East*, 40.

271 World Economic Forum, "Davos 2017 - Saudi Arabia Vision 2030," YouTube video, World Economic Forum, January 19, 2017, https://www.youtube.com/watch?v=ef8fjnTFGGo.

foreign workers.[272] More recent efforts to encourage individuals to work in the private sector are more promising than quotas and restrictions imposed on businesses in the past. Creating unemployment insurance for private sector employees is one example.[273] This points to the change that needs to occur in the social safety net, chiefly that the state will provide higher quality support to citizens who work. This will be a difficult sell, given the short-lived experiment of subsidy reductions in 2017 that the government restored within months. The low number of jobs created by previous Saudization programs clearly shows that the government must make some innovative and tough choices to get better results.

c. Youth

Job creation for young people who are entering the workforce is one of the most important tasks facing the economy's leadership. The royally mandated pay cuts in 2016 indicate that public sector is essentially operating at maximum labor capacity.[274] The old process of sending the upcoming generation to college in order to groom bureaucrats is no longer a guaranteed option for the individual nor a desirable path for the state. Another key issue related to youth employment is simply creating enough jobs. The rate of citizens coming of age into the labor market every year is outpacing the number of new jobs that the economy can create, while simultaneously the focus on seniority instead of capability as the path to promotion discourages young people from fully investing their talents in Saudi firms.[275] This disparity will increase the youth unemployment rate beyond the current rate of approximately 20 percent.

d. Women

Continuation of female employment patterns will perpetuate missed opportunities to increase output and TFP, and to reduce unemployed Saudis. Women are just under half

[272] Hertog, "Labor Market Nationalization Policies in the GCC," 91–93.

[273] IMF Staff, "Saudi Arabia: Selected Issues," 65.

[274] "Saudi Arabia to Tackle the Public Wage Bill," Oxford Business Group, November 11, 2106, http://www.oxfordbusinessgroup.com/news/saudi-arabia-tackle-public-wage-bill.

[275] Laura El-Katiri, "Saudi Arabia's Labor Market Challenge," Harvard Business Review, July 6, 2016, https://hbr.org/2016/07/saudi-arabias-labor-market-challenge.

of the population, and since more women graduate from universities than men, a huge portion of the type of people that the government is trying to push into the private sector lies underutilized. The NTP cannot succeed if women remain on the labor market fringes.

D. COMPOUNDING FACTORS

Several current dynamics play a complicating role in reform efforts moving forward. The amount of time that the country's progressive forces have at their disposal is running up against rising youth unemployment and the state's decreasing capacity to support its citizens. In the energy market, the Saudis' decades-long position of swing producer is under threat from the U.S. shale revolution. While this comparative advantage based on low oil extraction costs diminishes, existing rates of domestic oil consumption and concerns over peak demand in the future threaten the oil sector's ability to generate established revenue levels moving forward.

1. Limited Time

As Lippman aptly notes, one of the most important considerations that the Saudis face is "Whether they have the time to make the economy self-sustaining and sufficiently expansive before the country is overwhelmed by its population growth."[276] The paradox is that while the time remaining to reform the country's weaker economic and governance aspects is shrinking due to demographics and new dynamics in the international energy market, change must also occur at a rate that society can manage in order to actually create a meaningful impact and to prevent political discord. Rushing headfirst into modernization programs that the conservative populace does not support or that appear to stem from foreign influence are unlikely to succeed.[277] The monarchy's necessity for maintaining governance that supports the established social contract is one reason why "This authoritarian and centralized state struggle[d] so much with imposing regulatory change on bureaucracy and business."[278]

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276 Lippman, *Saudi Arabia on the Edge*, 98.

277 Anthony H. Cordesman and Khalid R. Al-Rodhan, *The Changing Dynamics of Energy in the Middle East*, Vol. 2 (Washington, DC: Center for Strategic and International Studies, 2006), 216.

278 Hertog, *Princes, Brokers, and Bureaucrats*, 246.

2. Redistribution's Threats

The government's ability to fund all of the aspects of the state in the future is being called into question. Degradation of revenue streams adds to claims that the economy's current composition is structurally unsustainable. Complicating this dire outlook is that the problem stems from both within and outside the country.

a. Domestic Energy Consumption

Rising domestic oil consumption is impacting state revenues and ultimately capacity. Current demand uses one-third of all production, leaving the remaining two-thirds to supply 80 percent of the government's revenues.[279] Ulrichsen notes that the resulting opportunity cost of lost exports that turn into cheap, subsidized domestic oil is approximately $70 billion annually.

Another paradox is that the bureaucracy needs significant sums of money to finance reform projects, yet low oil prices are what prompts reform. Thus, higher prices are needed to point to provide the resources required to implement change, yet affluence removes the sense of urgency that low prices introduce into society. The challenge is determining the equilibrium point between these competing forces.

b. Changing Energy Market

Saudi Arabia's status as the international crude market's swing producer stems from its ability to extract and produce at lower cost than other leading competitors; however, Saudi production operated at near full capacity until OPEC production cuts in December 2016.[280] New low-cost production, particularly from shale producers in North America, prompted the International Energy Agency (IEA) to forecast that the United States will surpass Saudi crude production by 2020.[281]

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[279] Ulrichsen, "Resource Security in Saudi Arabia," 174.

[280] Nayla Razzouk, "OPEC Confounds Skeptics, Agrees to First Oil Cuts in 8 Years," Bloomberg, November 30, 2016, https://www.bloomberg.com/news/articles/2016-11-30/opec-said-to-agree-oil-production-cuts-as-saudis-soften-on-iran.

[281] Cullen Hendrix and Marcus Noland, *Confronting the Curse: The Economics and Geopolitics of Natural Resource Governance* (Washington: Peterson Institute for International Economics, 2013), 70.

The type and quantities of energy that the global market demands are changing. Saudi crude faces intensifying international competition simultaneously with decreasing demand from established customers due to climate change policy implementation, (e.g., the Paris climate agreement).[282] Recent oil deals signed with China highlight the need for the kingdom's primary product, but also speak to the future since they include a nuclear energy component.[283] however, the market structure of the past four decades is evolving. Can Saudi Arabia do the same?

E. SUMMARY

Most of the kingdom's problems are structural. The changes that need to occur require fundamental shifts to move the bulk of the state's revenues away from oil sales, to make individual firms the driver of the economy, and to make Saudi citizens view the private sector as the optimum location to employ their talents. Structural change in just over a decade in a country with so many integrated economic and political restraints would be a significant achievement.

Government labor policies are essentially creating a reform trilemma, where Saudization, privatization, and diversification efforts are struggling to coexist. The problem is that all three aspects are needed to make the economy sustainable. The inference therefore is that the bureaucracy must redirect labor policy to make Saudi workers, particularly women and young people, more attractive to employers. Forcing quotas onto management has achieved little success thus far in reducing unemployment and will slow the transition of productive activity away from SOEs.

Top down Saudization programs that seek to create desperately needed private sector jobs to reduce unemployment among national citizens, particularly young people, ironically impede the privatization efforts that the government has simultaneously

[282] Pilita Clark, "Saudi Arabia Will Stick to Paris Accord Climate Change Pledges," *Financial Times*, November 13, 2016, https://www.ft.com/content/7471a4a8-a9b3-11e6-809d-c9f98a0cf216.

[283] Robbie Gramer, "Saudi Arabia, China Sign Deals Worth Up to $65 Billion," *Foreign Policy*, March 16, 2017, http://foreignpolicy.com/2017/03/16/saudi-arabia-china-sign-deals-worth-65-billion-boost-trade-ties-oil-energy-one-belt-one-road-saudi-vision-2030/. "Saudi Arabia Signs Cooperation Deals with China on Nuclear Energy," Gulf News, August 25, 2017, http://gulfnews.com/business/sectors/energy/saudi-arabia-signs-cooperation-deals-with-china-on-nuclear-energy-1.2079896.

worked to implement. The costs of hiring Saudi citizens is high enough that some businesses choose to follow market conditions instead of national priorities, resulting in relocation of operations to neighboring countries where labor remains affordable.[284]

Governance improvements are necessary to make the Saudi economy more sustainable.[285] Funding reform programs carries a price tag of several billion dollars, so the bureaucracy needs to keep enough cash on hand, or generate it via the Aramco IPO, to see Vision 2030 through to completion. The political capital that MbS has placed behind the initiative and the ease of securing investors during 2016's $17.5 billion bond issuance indicates that the government will have the necessary resources to do so. Nonetheless, the history of reform in the kingdom shows that economic policies tend to receive precedence over political changes. In the event that current accounts decline significantly and the leadership must prioritize funding of Vision 2030's programs, efforts to raise the country's low scores for voice and government effectiveness would likely lose funding before more prestigious diversification programs, (e.g., the Fiscal Balance Program).

Saudi reliance on patronage to manage dissent is not in line with the needed governance improvements. Most of the GCC spent its way out of the Arab Spring, while Egypt, Tunisia, Syria, and other poorer republics resorted to repression to quell unrest. If Saudi oil revenues continue to decrease over the long-term as a result of lower prices, international competition, increased domestic consumption, etc., the state's ability to weather another Arab Spring may steep to repressive action. This scenario represents worse governance, ultimately degrading the country's quest for economic sustainability.

284 Looney, "The Saudi Arabian Model," 496.

285 Ibid., 484.

V. CONCLUSIONS

A. VISION 2030 SO FAR

Researchers at Harvard and Chatham House have been conducting interviews in KSA to get an idea as to what kind of start Vision 2030 is having. Given the plan's aggressive timelines, which seek structural change in just over a decade, one would expect to find either strong enthusiasm to rise up to meet the challenge or a sense that what the government is asking of its employees and of society is too ambitious. Most citizens are still shaping their opinions based on a wide range of variables.

Expectations for the economy's performance were positive at the beginning of 2017 following a difficult 2016.[286] Nonetheless, oil prices have not bounced back and the IMF lowered its growth forecast for this year.[287] Karen House finds that social reforms are gaining ground, while economic measures are struggling to integrate into the new normal.[288] After the government announced Vision 2030 the Interior Ministry significantly curtailed the authorities of the notorious religious police, reducing their presence and stripping their ability to physically beat moral offenders.[289] The government is delivering on its promises to supply state sponsored entertainment, while many women are adopting more casual dress in public. As expected, critics see the changes as moral decay, not progress.[290] Nonetheless, social modifications are important to create confidence among the population that the government has the capability to execute the plan that it presented.

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[286] John Sfakianakis, "Saudi Economy Reaches a Fork in the Road" The National, January 29, 2017, https://www.thenational.ae/business/john-sfakianakis-saudi-economy-reaches-a-fork-in-the-road-1.89534.

[287] Alaa Shahine, "Saudi Economic Pain Will Test Resolve of Prince's Reform Push," Bloomberg, July 23, 2017, https://www.bloomberg.com/news/articles/2017-07-23/saudi-economic-pain-seen-testing-resolve-of-prince-s-reform-push.

[288] House, "Saudi Arabia in Transition," 13–23.

[289] Vivian Nereim, "Saudi Religious Police Return, Just With a Little Less Vengeance," Bloomberg, June 25, 2017, https://www.bloomberg.com/news/articles/2017-06-26/saudi-religious-police-return-just-with-a-little-less-vengeance.

[290] Ibid.

Popular support for Vision 2030 is the other critical aspect that can influence the plan's outcome, and so far, society is somewhat divided in its opinion of whether to buy into the new dynamics of working and living in KSA.[291] Some within the business community see the proposed changes as a threat to easy profits, while others view privatization positively, and a third group has adopted a wait and see attitude; nonetheless, Saudi citizens moved $300 billion out of the country over the past year.[292] While this is likely a sign of uncertainty, it runs counter to the government's attempts to increase FDI.

Part of the uncertainty stems from questions regarding potential changes to the relationship between the people and the state and the success of economic reform.[293] The lack of previous success in transforming the economy is naturally a reason for people to question if the outcome will actually be different this time. Political outcomes are also hard to predict, and there is little indication so far if the monarchy will grant the people more political agency in order to stimulate private economic activity.[294]

B. HYPOTHESES

A useful way to analyze the hypotheses is by evaluating the outcome on economic and social reform if improvements took place in each area. The idea is essentially to determine if any of the hypotheses are false positives, (i.e., ascertaining if eliminating the oil curse or creating a more competitive economy will lead to economic reform improvements in other areas). If change does not occur after modifications to an independent variable, then the hypothesis at hand is correlatively linked but not a causal factor. A short review of the findings included throughout this paper will facilitate such a discussion in the final section.

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291 House, "Saudi Arabia in Transition," 13.

292 Ibid., 13, 20.

293 Kinninmont, "Vision 2030 and Saudi Arabia's Social Contract," 17.

294 Ibid., 41.

1. State & Society

Patronage shapes the Saudi system in many ways, to include how the state functions and how KSA fits into rentier theory. Hertog's assertion that the "Government bureaucracies are segmented, with parallel structures dominated by different members of the royal family," indicates that improving governance will not be as simple as simply forcing top-down changes upon the bureaucracy.[295]

The state also directly drives the economy via the primary SOEs. A few successful PPPs demonstrate that the government is able to relinquish partial control of these companies, but is unwilling to fully privatize. Policy makers must decide if the government can sacrifice political ownership in order to generate a more market based economy. The NTP's message that touts privatization comes across as slightly contradictory if the state does not lead by example with the companies that really matter.

Opposition to change is strongest among the portions of society that stand to lose out economically, politically, or socially to changes to the status quo. This reality is not surprising, but the scope of the changes that Vision 2030 seeks is so significant that the issue runs deeper than identifying winners and losers. Social liberalization is questioning Wahhabi authority as a source of legitimacy, which threatens clerical influence on education and public behavior. Popular support for MbS' plan is a referendum on Saudi identity.

2. Oil Curse

The kingdom is ultimately better off having oil, as it enabled significant increases in the quality of life for citizens by raising human development indicators and providing higher incomes for portions of society. Oil wealth led to the construction of critical infrastructure and supported political stability in a region that has seen multiple civil wars and failed states; however, the country's vast resources are not distributed equally, with many Saudis living in poverty or struggling to afford housing.

[295] Hertog, *Princes, Brokers, and Bureaucrats*, 98–102.

The state has come to depend on crude export revenues, indicating that several aspects of the oil curse exist in the country. The most significant outcome is the history of volatile and underperforming growth. Governance problems are the primary cause that makes oil abundance become a curse. Reforms do not occur in isolation, so governance stasis will negate overall reform. Comparative advantage is the primary limit to expanding agriculture, although Dutch disease has impacted manufacturing. Continuation of the existing model will make transitioning to a manufacturing economy difficult, while moving to a knowledge economy is currently out of reach.

3. Market Inefficiencies

MbS is pushing for structural change over the course of a decade, which is a very significant and difficult goal to achieve. The government has implemented several policies designed to regulate job creation for citizens in the private sector. Besides having little impact, these efforts more importantly created problems for privatization goals. The government cannot force its people into the private workforce, so it needs to promote the private sector as the most attractive place for its citizens to work.

Stage theory shows that improved governance and revised policies are needed to move the economy to the next phase of production. Since the state manages the education system, it should continue its efforts to equip graduates with the necessary human capital skills necessary to increase the economy’s competitiveness. These performance indicators do not currently impede economic reform, since governance limitations are holding back economic change; however, if government policies do change, then Saudi companies and employees will need to be able to compete internationally as manufacturing increases in the overall composition of Saudi GDP.

C. IMPLICATIONS

The weak record of economic reform is ultimately a political problem. Politics connects all the hypotheses presented in this paper. Although economic and social change is the focus of KSA’s reform efforts, policy modifications in these areas will not be as profound and impactful compared to political liberalization. Improving governance and reducing patronage are the most significant actions that the government can take to achieve its economic and social goals. The political system shapes the structure of the state and the relationship between the people and the government. Removing the causes of the oil curse is a matter of improving governance. Economic policies can help ameliorate conditions, but only political choices and behaviors can end reliance on oil revenues. The competitiveness of Saudi firms and workers depends in large part on the state relinquishing control of the economy to foster an environment that supports businesses, but also spurs them to independence by removing rentier incentives. Evading political reform is no longer in the best interest of the al Saud family or of the state that it rules.

1. Political Problems

The dominant role that patronage plays in the Saudi system shapes political behavior and alliances, influences economic decisions, and restricts the leadership's maneuverability to change the status quo. Hertog outlines the core problem that patronage creates for reform: "Rent distribution means incurring obligations, even if individualized, and those can reduce a regime's leeway to change institutions over time. This is perhaps the most striking feature of state autonomy in Saudi Arabia as rentier state: oil money initially gave its elites vast autonomy to create and reshape institutions. This autonomy however, has declined precipitously."[296] MbS faces an uphill battle in reducing the role of the state in society and in the economy since the existing structure regulates the actual degree of autonomy with which the state can operate.

The country's political dynamics begin a chain that intertwines all of the hypotheses and underpins the decades long record of weak economic reform. Patronage shapes the state's structure, which in turn leads to governance shortfalls. This shortcoming leads to the aspects of the oil curse that are present in KSA, which in turn produce economic consequences that manifest in the labor market and the structure of the economy. These outcomes create conditions where the country's population, businesses, and means of production rely on the state, bringing the process full circle and ultimately creating cycles that reforms have difficulty breaking.

[296] Hertog, *Princes, Brokers, and Bureaucrats*, 267.

The government must decide how much of a mixed economy it truly desires. The kingdom has several of the world's most professional SOEs, and it can maintain sufficient political control over the economy and move away from oil revenues by diversifying these companies' activities. If the state is unwilling to cede its grasp on the factors of production, the private sector will not become the main engine of economic growth and the primary employer of citizens. To achieve many of the NTP's targets, the state needs to reduce its efforts in driving the economy and shift focus to enabling growth.

Creating an environment that supports private economic growth requires a corresponding social safety net. Entrepreneurs will take more risks if the state redistributes resources to support small businesses. Welfare programs need to target the poor and the growing number of youth who are minimally prepared to compete in the private sector against foreign labor. This is important for the state to manage expectations and unrest, in addition to taking care of its most vulnerable citizens. The state's push to social liberalization is winning the support of many young people, so it is not surprising that Vision 2030's social reforms are moving faster than its economic priorities. The state needs allow political change to accompany such social changes to maximize its return on investing in both social and economic liberalization. This does not imply that democratization is the next logical step, but increased tolerance for hearing the public's voice will pay off, while the old model of punishing dissent is not viable with the path the state has chosen.

2. Avoiding Political Reform

The challenges to creating change are complex, but the monarchy historically did not face external pressure to modify the economy. Leaders enacted policies designed to diversify and privatize for the benefit of future generations, without an immediate reason to impose reform swiftly. The rentier governance model and the resultant social contract proved successful at creating stability, improving human development and infrastructure modernization, and making the elite very wealthy. While economic growth proved volatile and fell below the potential of the country's natural resource abundance, the state had the resources it needed to make life better for most citizens and to ensure the monarchy’s political dominance. Geopolitical alliances with the United States and the GCC removed foreign pressure to subject the economy to Washington Consensus policies, which in turn quieted foreign diplomatic calls for social change or human rights improvements.

The desire of Middle Eastern elites to guard their authority translated into an almost active avoidance of political reform, and harboring this attitude has come at a cost. Cammett et al. argue that “The main culprit, then, for the weak performance of Arab economies could very well be the strategy of ‘economic reforms first, and political reforms later,’ which led to the rise of networks of privilege with myopic short-term interests that stifled competition and innovation.”[297] Vision 2030 pays lip service to political change by stating that some governance improvements will be made. Hopefully such changes will occur; however, the proposals do not equal a significant move away from the established patterns of rule by which the al Saud have governed for 85 years.

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[297] Cammett, *Political Economy of the Middle East*, 54.

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