Privatisation in the context of the Saudi Arabian economy: an examination of the attitudes of Saudi private investors towards privatisation in Saudi Arabia

This item was submitted to Loughborough University’s Institutional Repository by the/an author.

Additional Information:

- A Master’s Thesis. Submitted in partial fulfilment of the requirements for the award of Master of Philosophy at Loughborough University.

Metadata Record: [https://dspace.lboro.ac.uk/2134/27356](https://dspace.lboro.ac.uk/2134/27356)

Publisher: © Mohammed N. H. Al-Sarhan

Rights: This work is made available according to the conditions of the Creative Commons Attribution-NonCommercial-NoDerivatives 2.5 Generic (CC BY-NC-ND 2.5) licence. Full details of this licence are available at: [http://creativecommons.org/licenses/by-nc-nd/2.5/](http://creativecommons.org/licenses/by-nc-nd/2.5/)

Please cite the published version.
This item was submitted to Loughborough University as an MPhil thesis by the author and is made available in the Institutional Repository (https://dspace.lboro.ac.uk/) under the following Creative Commons Licence conditions.

For the full text of this licence, please go to: http://creativecommons.org/licenses/by-nc-nd/2.5/
PRIVATISATION IN THE CONTEXT OF THE SAUDI ARABIAN ECONOMY

An Examination of the Attitudes of Saudi Private Investors towards Privatisation in Saudi Arabia.

MOHAMMED N. H. AL-SARHAN

Submitted to the Department of Economics of Loughborough University in fulfillment of the requirements for the Degree of Master of Philosophy.

1995
Acknowledgment

This work was made possible by the cooperation of several government departments and private sector organisations in the Kingdom of Saudi Arabia, and through encouragement and understanding of many individuals in those agencies. I thank them.

In particular, I owe much gratitude to Mr. Abbas Arafat, Director of Library and Documentation of the Ministry of Planning, for supplying innumerable materials and documents, and to my colleagues in Jubail Industrial College, Mr. Amjed Begg, Mr. Jimmy Torres, Mr. Amanullah Khan, Mr. Faisal Attar who grappled with my handwriting and enabled this thesis to be submitted in a correct and coherent form and Mr. Desmond Kirby for his useful comments and suggestions which greatly improved this work. Their wholehearted and friendly support has been of immeasurable assistance.

Much appreciation, gratitude and special thanks to my advisor Professor John Presley, in the Department of Economics at the University of Loughborough, for his encouragement and valuable advice. His keen interest and continued assistance throughout this study was inspiring and is immensely appreciated.

Special thanks is due to my beloved wife for her moral support and sacrifices which remain a great source of happiness and strength, I so often needed.
Abstract

Privatisation, nowadays, is seen as an important factor in the economic development of many countries. This is mainly in search of “economic efficiency”, improvement in the quality of services and the wider distribution of wealth which result from the privatisation initiatives. While the specific reason for this policy varies from one country to another, there is common and shared dissatisfaction with the performance of a large number of State-Owned Enterprises (SOE).

However, the main theme of this study is that privatisation should be viewed, discussed and analysed within the context and circumstance of every individual country independently. This is because privatisation in India, for example, with a low GNP per capita and high population growth rate is not necessarily the same as in Britain. And thus privatisation in Britain with a high level of unemployment and trade union problems is naturally different from Kuwait, Jordan, or Qatar.

This study examines privatisation within the context of the Saudi Arabian economy, and the nature and consequence of the Kingdom's development plans. Saudi Arabia is a vast country of diverse features. In many ways it is still a developing country. It has 21st century technology and infrastructure but it must be remembered that the industrial revolution which took place in Europe, United States and Japan in the 19th century has only really taken place in Saudi in the past 25 years - and is indeed still continuing, with its accompanying social implications. The study also examines, within this context, the attitudes of the Saudi businessmen towards privatisation. In other words, what from their points of view can be privatised and what can not be privatised? How much are they prepared to invest in privatisation projects? What, from their perception, are the advantages and disadvantages of such a policy?

This study makes several findings concerning the public sector, the private sector, the financial market and barriers to privatisation.

Out of these analyses a privatisation plan is developed; this embodies the conclusion that the socio-economic environment in Saudi Arabia is favourable to foster privatisation. However, this policy-option should be reviewed critically, planned carefully and introduced gradually.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>1</td>
</tr>
<tr>
<td><strong>INTRODUCTION</strong></td>
<td></td>
</tr>
<tr>
<td>II</td>
<td>9</td>
</tr>
<tr>
<td><strong>SAUDI ARABIA</strong></td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>36</td>
</tr>
<tr>
<td>IV</td>
<td>54</td>
</tr>
<tr>
<td>V</td>
<td>119</td>
</tr>
<tr>
<td><strong>BACKGROUND TO PRIVATISATION IN SAUDI ARABIA</strong></td>
<td></td>
</tr>
<tr>
<td>VI</td>
<td>135</td>
</tr>
</tbody>
</table>
The Public Sector, Subsidies, Manpower Shortages, Inadequate Information, and Attitudes of Public Officials.

Revenue Raising, Subsidies, Efficiency, Tax Base, Market Forms, Financial System, Redistribution of Wealth, Macro Implications, Unemployment, Access to Services

Major Findings, Suggestions, Privatisation Plan, Ideas for Further Research

BIBLIOGRAPHY

APPENDIX: QUESTIONNAIRE & SURVEY DATA
# LIST OF TABLES

<table>
<thead>
<tr>
<th>Table No</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>The distribution of the survey population into strata</td>
<td>8</td>
</tr>
<tr>
<td>2.1</td>
<td>Banks' claims on the private sector</td>
<td>31</td>
</tr>
<tr>
<td>2.2</td>
<td>Commercial banks' credit by economic activity 1991 - 1993</td>
<td>32</td>
</tr>
<tr>
<td>2.3</td>
<td>Estimated percentage ownership of shares of joint stock companies</td>
<td>33</td>
</tr>
<tr>
<td>3.1</td>
<td>Composition of Gross Domestic Product at current prices 1989 - 1994</td>
<td>45</td>
</tr>
<tr>
<td>3.2</td>
<td>Allocation of civilian development expenditures during different development plans</td>
<td>51</td>
</tr>
<tr>
<td>3.3</td>
<td>Total government expenditure on development 1980 - 1985</td>
<td>52</td>
</tr>
<tr>
<td>4.1</td>
<td>U.K sale proceeds from privatisation 1979 - 1990</td>
<td>94</td>
</tr>
<tr>
<td>4.2</td>
<td>Breakdown of public enterprises by sector</td>
<td>101</td>
</tr>
<tr>
<td>5.1</td>
<td>Structure of SABIC paid-up capital</td>
<td>123</td>
</tr>
<tr>
<td>5.2</td>
<td>SABIC industries and affiliates</td>
<td>125</td>
</tr>
<tr>
<td>6.1</td>
<td>Frequency and percentage of respondents: by age</td>
<td>139</td>
</tr>
<tr>
<td>6.2</td>
<td>Frequency and percentage of respondents: by educational background</td>
<td>140</td>
</tr>
<tr>
<td>6.3</td>
<td>Frequency and percentage of respondents: by experience in years</td>
<td>141</td>
</tr>
<tr>
<td>6.4</td>
<td>Expected benefits of privatisation in Saudi Arabia</td>
<td>145</td>
</tr>
<tr>
<td>6.5</td>
<td>Impact of privatisation on the development and growth of small businesses</td>
<td>148</td>
</tr>
<tr>
<td>6.6</td>
<td>Perception of businessmen of the financial market</td>
<td>156</td>
</tr>
</tbody>
</table>
6.7 Proposed projects for privatisation

6.8 Frequency and percentages of “Strongly Favour” to the item describing public organisations and enterprises as candidates for privatisation

8.1 Percentage of government participation in selected publicly traded companies
# List of Figures

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Map of Arabian Peninsula</td>
<td>12</td>
</tr>
<tr>
<td>2.2</td>
<td>Structural Organisation of the Financial System In Saudi Arabia</td>
<td>19</td>
</tr>
<tr>
<td>3.1</td>
<td>Themes of The Saudi Arabian Development Plans</td>
<td>45</td>
</tr>
<tr>
<td>6.1</td>
<td>General Support for Privatisation</td>
<td>142</td>
</tr>
<tr>
<td>6.2</td>
<td>Support and Introduction Schemes</td>
<td>143</td>
</tr>
<tr>
<td>6.3</td>
<td>Individuals’ Saving to be Invested</td>
<td>149</td>
</tr>
<tr>
<td>6.4</td>
<td>Attitudes Towards Direct Foreign Investment</td>
<td>151</td>
</tr>
<tr>
<td>6.5</td>
<td>Attitudes Towards Public Share Holding</td>
<td>152</td>
</tr>
<tr>
<td>6.6</td>
<td>Attitudes Towards Public Share Holding Based on Different Nationalities</td>
<td>153</td>
</tr>
<tr>
<td>6.7</td>
<td>Timing of Privatisation</td>
<td>162</td>
</tr>
</tbody>
</table>
## List of Diagrams

<table>
<thead>
<tr>
<th>Diagram</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Equilibrium under Perfect Competition</td>
<td>62</td>
</tr>
<tr>
<td>2. Monopoly Profit</td>
<td>77</td>
</tr>
<tr>
<td>3. The Efficiency of Competitive Equilibrium</td>
<td>79</td>
</tr>
<tr>
<td>4. Production Possibility Curve</td>
<td>82</td>
</tr>
<tr>
<td>5. Increased Demand for Labour</td>
<td>84</td>
</tr>
<tr>
<td>6. Fall in Demand for Labour</td>
<td>85</td>
</tr>
<tr>
<td>7. Demand, Supply, Price, and Subsidy Removal</td>
<td>184</td>
</tr>
<tr>
<td>8. Allocative and Productive Efficiency in a Perfectly Competitive Market</td>
<td>185</td>
</tr>
<tr>
<td>9. Demand, Supply, Price and Subsidies</td>
<td>186</td>
</tr>
<tr>
<td>10. Loss Making Natural Monopoly</td>
<td>188</td>
</tr>
<tr>
<td>11. Perfect Competition v Monopoly</td>
<td>190</td>
</tr>
<tr>
<td>12. International Market Position of Saudi Heavy Industry</td>
<td>191</td>
</tr>
</tbody>
</table>
Chapter One

INTRODUCTION
Rationale for the Study and Objectives

Saudi Arabia, like many developing economies, aims to achieve long-term economic growth and stability. Such a policy has been pursued through different economic strategies. The most announced and consistently undertaken is the strategy of "structural adjustment, change and diversification". It is very important to reduce reliance on oil and develop the producing sectors such as agriculture and industry.

There are other supporting techniques to facilitate the achievement of such a strategy, including provision of "subsidies" which has served during nearly the last twenty years as an important economic tool for the progress that has been made in both agricultural and industrial sectors in the Kingdom. However, "government subsidies" are no longer feasible, either because they have served their purposes and their continuity may reverse their results, or because it is not possible financially to pay them any more.

As an alternative, many developing countries and especially Saudi Arabia for that matter, are adopting "privatisation" as an important component of the structural change package. This is because privatisation opens up opportunities for private sector participation and investment, reduces operations of public enterprises which usually drain the public budget, introduces efficiency measures and consequently leads to expansion of services, balances the budget deficit and encourages technological changes.

However, these benefits vary from one situation to another. Their attainment depends on factors embodied in the tradition or circumstances of every particular country.
This work aims to discuss privatisation as a new economic policy option in the context of the Saudi Arabian economy and development, with a view to examining the attitudes of the private investors in Saudi Arabia towards privatisation. The scope of activities of this research will focus on analysing:

1. The potential benefits and returns of a privatisation programme in Saudi Arabia.
2. The economic and social implications of privatisation in Saudi Arabia.
3. The private sector's ability to run large government enterprises.
4. The logistical requirement i.e. manpower skill, resources, systems and support for the implementation of a successful privatisation programme in Saudi Arabia.

**Statement of the Problem**

Within the context of economic development in Saudi Arabia many problems have emerged, and their continued presence may hinder the implementation of an effective privatisation programme.

The essence of the problem is rooted in the structure of the Saudi Arabian economy itself which depends mainly on oil sector revenues to finance development, expenditure and investment. This, despite the remarkable achievements in many sectors of the economy, has resulted in two compounded problems:

a. The creation of an over-extended public sector with complicated administrative inefficiency. This, by implication, makes some of the state-owned enterprises unattractive for sale due to their inefficient performance.
b. Under-utilization of the private sector's capital resources which have been invested abroad during the boom years, mainly as a result of continued reliance on the state to provide services.

The private sector has only recently become active in providing services such as health, education, import and retail trade etc. Despite generous government support and consequent marked growth of the private sector, the participation of this sector in financing development and investment in the Kingdom is still small.

However, Saudi Arabia is now experiencing a real economic recession and growing financial deficit. Saudi Arabia is currently considering some important alternatives such as "privatisation". This is particularly true in view of the fact that the overall account deficit is not likely to come down because much of the growth being generated by government spending is not investment-led. Privatisation could be used as an instrument for both generating future investment and creating new business opportunities, as well as maximizing revenues for the government through sale proceeds in order to solve the more immediate problem of deficit.

But in practice, privatisation requires full government as well as private sector commitments. This research intends to investigate the private sector investors' attitudes towards privatisation in terms of support, participation and ability to identify and manage proposed projects for privatisation.
Structure & Presentation

This work is structured to provide, at the very beginning, a good back-ground about Saudi Arabia. This is very important in order to examine various factors that might influence the decision to privatise or not to privatise.

Therefore, chapters two and three are mainly introductory and will focus generally on Saudi Arabia, its geographical structure, population, organisation of the economy, political and financial system, as well as revision of the national development plans’ policies. The role of the private sector in particular and its contribution to development will be emphasized in the third chapter with the intention of providing the basis for the further discussion of privatisation that follows.

The fourth chapter is mainly a review of related literature and seeks to establish a full definition of privatisation supported by examples taken from both advanced and developing economies. The main purpose of this chapter is to set the main body of the work in its specific context, with an attempt to understand why “privatisation” is adopted as a new policy for change. This discussion will cover various aspects related to advantages and disadvantages of privatisation, the relationship between privatisation and economic efficiency, and the typical procedure or mechanics of privatisation.

The fifth chapter aims to give specific background to privatisation in Saudi Arabia. It examines the early experience, presents some examples, and analyses the implications of recent initiatives.

The sixth chapter is mainly an analysis of the field survey. This section will focus on examination of attitudes of Saudi private investors towards
privatisation with respect to support, identification of projects for privatisation, investment, participation, methodology, and timing.

Chapter seven analyses, specifically, barriers to privatisation. While chapter eight focuses mainly on the economic and social implications of privatisation in Saudi Arabia with the intention to assess the impact of this programme in both terms, chapter nine presents the major findings and provides some suggestions as an action plan for privatisation.

**Methodology**

In the most descriptive parts of this thesis, I have examined, evaluated and critically reviewed almost all available, reliable, documentary evidence to present and write the theoretical section and background details. Individuals' and experts' views were obtained through interview and meetings with officials in both government agencies and industrial plants. A great deal of statistical information was obtained by means of a field survey through a specially designed questionnaire.

**Profile of the Survey**

The survey has been designed to examine the attitudes of the private sector investors towards privatisation in Saudi Arabia. In other words, are they supportive, or not? The questionnaire consists of seven sections, as can be seen in the Appendix. The first section seeks to analyse the general support and major objectives for privatisation; identify proposed projects for privatisation; discuss attitudes towards investment and participation in the programme.
While section two attempts to outline the expected benefits, section three seeks to identify expected disadvantages. Section four assesses attitudes towards timing of privatisation and section five is devoted to identification of major constraints. Section six examines attitudes towards the business environment in Saudi Arabia and section seven is designed to examine the respondents views on procedures and the mechanism of privatisation. The domain of the survey was limited to the cities of Riyadh and Dammam - being the centres of business and trade.

The number of participants amounted to 47 as a probability sample which was carefully selected in order to ensure the accuracy and quality of the answers. The procedure of sampling is based on the “Stratified Random Sampling” method in which the elements (the respondents) have been split into segments (strata) as in table (1.1).

Samples are selected from within each stratum and their views represent the perception of businessmen in that particular sector. All information is combined to make an inference about the entire survey population.

“Stratified random sampling has another advantage. You can not only combine the information in the strata samples to make inferences about the complete population, but you can also use the sample information about the characteristics of each stratum”. (1)

---

Table 1.1
THE DISTRIBUTION OF SURVEY POPULATION INTO STRATA

<table>
<thead>
<tr>
<th>STRATA CATEGORY</th>
<th>No.of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Industry</td>
<td>9</td>
</tr>
<tr>
<td>2. Banking &amp; Investment</td>
<td>7</td>
</tr>
<tr>
<td>3. Construction</td>
<td>3</td>
</tr>
<tr>
<td>4. Manufacturing</td>
<td>3</td>
</tr>
<tr>
<td>5. Services (Training/Consulting &amp; Others)</td>
<td>11</td>
</tr>
<tr>
<td>6. Commercial Services (Sales, Marketing, Export/Import)</td>
<td>8</td>
</tr>
<tr>
<td>7. Agriculture</td>
<td>3</td>
</tr>
<tr>
<td>8. Government Organisation</td>
<td>2</td>
</tr>
<tr>
<td>9. Chamber of Commerce</td>
<td>1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>47</td>
</tr>
</tbody>
</table>

Although the survey is designed exclusively to examine the perception of Saudi businessmen in the private sector towards the matter under discussion, the survey also includes some government agencies in order to balance the discussion between the official attitude of the government to privatisation and that of the private sector.

Further discussion of the research methodology and content will take place in more detail in chapter six.
Chapter Two

SAUDI ARABIA:
Geographical Features, Population,
Political System & Financial System
This chapter is presented to signify the importance and implications of Saudi Arabia's own circumstances and systems to the issue under discussion.

At the outset, privatisation is generally governed, shaped and influenced by certain factors in a given context. Therefore, privatisation in India with mass-population and low income per capita is not necessarily the same as in Sweden or Yemen for example.

Thus, the geography of Saudi Arabia or its size of population or political system are very important factors that direct the scale and timing of privatisation in this particular country. The size of the land mass is huge, and, therefore, can be taken as influencing motives towards privatisation and subsequently franchising of services to reach every area in the Kingdom. The size of population is small and, therefore, may encourage the introduction of privatisation on a large scale as manpower associated problems like redundancies or mass-unemployment can be minimized in such a situation.

**GEOGRAPHICAL FEATURES**

Saudi Arabia occupies approximately four-fifths of the Arabian peninsula. The land mass amounts to 2.3 million square kilometers. This is an area roughly nine times the size of U.K., two thirds of the size of India, a quarter that of the U.S.A., slightly larger than Iran and Iraq together and the same as continental Western Europe. In respect to privatisation, this structure may necessitate the introduction of privatisation on a large scale for the purpose of distributing services instead of centralized public sector administration located in the capital and major cities.
Saudi Arabia is bordered to the west by the Red Sea; to the north by Jordan, Iraq and Kuwait; to the east by the Arabian Gulf, Qatar, The United Arab Emirates and Oman; to the south by North Yemen and South Yemen as shown in figure 2.1.

The country's topographical formation is diverse, beginning with the narrow coastal plain along the Red Sea in the west. The east contains a predominance of sedimentary rocks which, in turn, contain the all important oil fields. In the centre lies the Najed Plateau, approximately 650,000 square miles with an average height of 4,000 to 6,000 feet. The elevation drops to 2,000 feet at the Ad-Dahna which faces the Arabian gulf. The Najed Plateau extends southward to Wadi Al-Dawasir then up to the border of Rub-Al-Khali (The Empty Quarter).

There are several mountain areas in Saudi Arabia including Asir in the south-west, which extends over 40,000 square miles and which has the highest peaks in the country (over 2,743 meters). Furthermore, there are mountainous areas in Najed, namely Aredh and Uwairedh, Mt. Aja and Mt. Selma and the Tuwaiq range which runs from south-west to north-west into the Nafud (dune ridges extending towards the north).

Diversity in geographical features is matched by a diversity in mineral resources. Among these, crude oil dominates, and reserves are estimated at 250 billion barrels - over one fourth of the world's proven resources.
FIGURE (2.1)

MAP OF THE ARABIAN PENINSULA
The Arabian Shield is known to contain a large number of other mineral deposits such as copper, zinc, lead, gold and iron, chromium, titanium, tungsten and lithium. In addition to mineral deposits, marble and construction materials are readily available. Such a variety of resources yield opportunities to the private sector for participation and investment.

THE KINGDOM'S POPULATION

Official published information in the Population Census was announced in December 1992. The figures show that Saudi Arabia's total population has reached 16.93 million, of which 4.62 million are non-Saudi. This indicates a continued reliance on a non-Saudi work force that began in 1975.

The number of Saudi nationals reached 12,304,835, or 72.7 percent of the total population, of which 6,211,213 are males and 6,093,622 or 49.6 percent are females. The overall annual rate of growth of the indigenous population is four percent. This means Saudi Arabia has an extremely high rate of population growth.

"In terms of wealth distribution, this means that per capita income of ordinary Saudis is only likely to increase by between 1% and 2% so long as overall economic growth remains around the 5% - 6% mark. Given the dramatic collapse in per capita income since the mid-1980's, such growth may not be enough to head off discontent. There is thus likely to be considerable pressure on the government to pursue expansionary policies, even at the risk of substantially increased budgetary and current account deficits". (1)

In terms of privatisation, the implications of this structure could signify the following: (a) possible creation of unemployment among Saudi citizens especially in view of the fact that privatisation usually leads to severe cuts in the work-force and that there is a much larger indigenous population than had generally been suspected, (b) possible reduction in the number of expatriate workers in the Kingdom, and (c) while there is a possibility of wider distribution of wealth and increased benefits for workers and small share holders, it is also possible that privatisation will limit access to some public services or at least increase the prices of such services, e.g. telecom, which might economically worsen the situation of Saudi middle-income families.

THE POLITICAL SYSTEM

Modern Saudi Arabia was formally proclaimed only in 1932, when the late King Abdul Aziz united the Arabian sheikdoms under one kingdom.

"The formal political structure of Saudi Arabia is fairly simple and straightforward to describe. More difficult is to understand quite how policies are molded and power exercised. The country is ruled by an absolute monarchy in which individuals have considerable rights and freedom in law, but few political rights. There is no suffrage, there are no political parties and unions are illegal". (1)

The government administrative process is highly centralized in the capital Riyadh. Local and regional governmental units normally handle internal security problems and administration of the Municipalities, while central government combines legislative, judicial and executive functions through the King, the Crown Prince and the Council of Ministers. There is also a group of advisory planning organizations which form a consultative council and a

---

group of judicial, theological and law interpretation and educational institutions. (1)

In April 1992, King Fahed, in an attempt to modernize the government system and widen public participation, issued three Royal Decrees for Basic Law for Government, Consultation and Region Administration. This development was welcomed both in the Kingdom and abroad as it set Saudi Arabia on its first steps towards modern democracy. Such developments are very significant because they provide a basis for progression through further participation. Moreover, this new network of political regulatory relationships may help in implementing far reaching economic changes such as "privatisation" which usually require political support and de-centralization.

Also, Saudi Arabia is a politically stable country. This is a very important element in creating a favourable business-environment and subsequently fostering privatisation.

**The Financial System**

Typically the function and the role of any financial system include:
1. helping to monetize the economy in order to facilitate capital formation;
2. promoting general efficiency in the economic system;
3. responding to credit needs which shift with long-term development;
4. promoting economic stability;
5. effecting transitional and operational efficiencies;
6. aiding in the channeling of income towards productive investment;
7. developing or aiding in the evolution of necessary financial intermediaries. (2)

---

Those objectives are very important and relevant to the financial requirement of privatisation which calls for an efficient financial system that aids transactional operational activities, and provides adequate support to private investment institutions.

In general, the Saudi financial system is structured to respond to such requirements. The system is administered and controlled mainly by the government through the Ministry of Finance and National Economy, which operates through the Saudi Arabian Monetary Agency (SAMA) and semi-government funding institutions.

The following discussion intends to discuss this structure with reference to privatisation in an attempt to assess its appropriateness to the programme. Is this structure adequate and supportive enough to facilitate the introduction of privatisation? Can privatisation be introduced with the absence of a stock market? What will be the impact of privatisation on the future development of the financial market itself? This discussion will be presented under three headings i.e. Monetary Policy, Objectives and Structure.

Monetary Policy and Objectives

In Saudi Arabia, the Monetary Policy, as illustrated in the functions performed by SAMA, aims to maintain monetary stability and promote economic growth. In general, such a policy is in conformity with the overall strategy of “Economic Diversification”. Monetary stability, however, is seen to be achieved through regulating money supply and maintaining the external value of the riyal. The riyal, generally, is not allowed to float in the international markets. Oil, which is the main source of revenue for the government, is usually sold in dollars. But because of the instability of the dollar SAMA from
time to time devalues or revalues the riyal against the dollar, to maintain a specific exchange rate. This is in addition to connecting the riyal to the SDR.

Also, some of SAMA’s holding is kept in gold rather than foreign exchange. This is because the value of gold, in terms of other foreign currencies, is not affected by the behaviour of any particular currency.

On a more long-term basis, the emphasis of the monetary policy is on development of an adequate monetary and banking system to handle the financial needs of both the public and private sectors.

The most pressing need at the present time is the support that this system is required to provide for privatisation, which simply can not be pursued without the support of an adequate financial system. In Britain, for example, the success of the British privatisation programme can be attributed, in part, to the strong financial institutions in London.

However, with the continued emphasis on diversification and the current policy of privatisation, it is expected that there will be increasing dependency on the availability of finance from the commercial banks and other financial institutions.

"The financial services sector (banking, insurance, business services) accounted for 6.2 percent of non-oil GDP in 1409/10, and this share is targeted to increase to 7.2 percent in 1414/15, with an average annual growth rate of 6.6 percent in the Fifth Plan period". (1)

---

The Fifth Development Plan (1990-1995) introduced the following initiatives:

1. Attracting a higher proportion of private saving for investment in the domestic economy by providing profitable, safe, and marketable financial investments.

2. Encouraging banks to expand their domestic lending and to provide a wider range of financial services.

3. Developing a more broadly based private financial system, through the growth of non-bank financial intermediaries whose services compete with and complement the commercial banks, especially those which are potential sources of long term credit, such as equipment leasing companies and cooperative insurance companies.

4. Encouraging the development of efficient capital markets, particularly a more active and efficient equity market. (1)

Although it is not clear how those policies will be achieved, if, however, such initiatives are introduced, they should lead to many tangible benefits, including enforcing the shifts towards the private sector, disbursement of funds to productive uses in the economy, offering of investment opportunities, and the repatriation of Saudi private sector financial assets held abroad as well as encouragement of new foreign direct investment in the Kingdom.

The Structure of the Financial Market

There are four key-role players in the financial market in Saudi Arabia, namely: Ministry of Finance and National Economy (MFNE); Saudi Arabian Monetary Agency (SAMA); Commercial Banks, including the stock-market which operates mainly through those banks; and the Credit Institutions, as can

---

be seen from figure (2.2). The following discussion will focus on the potential role of each institution in the introduction of privatisation in Saudi Arabia.

**Figure (2.2)**

**STRUCTURAL ORGANISATION OF THE FINANCIAL SYSTEM IN SAUDI ARABIA**

- **Ministry of Finance & National Economy**
  - **Credit Institutions**
  - **SAMA**
    - **Commercial Banks**
      - **Stock Market**

**Ministry of Finance & National Economy (MFNE)**

As mentioned earlier, the overall responsibility for control of the system and its administration is carried out by the Ministry of Finance which sets policies, procedures, practices and various regulations. MFNE was established in 1932. It is organised around three main responsibilities; budget, revenue and administration. In respect to budget, the Ministry prepares and presents both recurrent expenditure and development programmes' allocation. The Council of Ministers carries responsibility for controlling expenditure against budget.
"The Ministry's revenue collection activities are more straightforward than is the case in most other countries, since no income tax is levied on Saudi Companies or citizens—indeed, foreign employees do not at present pay income tax either, though foreign companies, including the non-Saudi partners of joint ventures, do. Saudis do however, pay a small annual religious tax on wealth, the Zakat, which stems from the requirements of Islam for aims-giving by the better-off to the poor. Most Saudis paying Zakat see it as an honourable obligation to be fulfilled conscientiously". (1)

Thus the Ministry, by virtue of its status, is the party responsible for policy-making, regulation and control, which make it the prime mover in any future privatisation programme.

**The Saudi Arabian Monetary Agency (SAMA)**

The main function of SAMA is to act as Central Bank, offering commercial banking services to the government by providing different ministries a full range of financial support. Currently this role has been extended to investment activities on behalf of the government as well as participation in the development of the financial system in the Kingdom. SAMA has made significant contributions towards commercial banking development, which is an important instrument for privatisation, and stock market development which is also an important vehicle for the implementation of the programme. This is demonstrated through the introduction of the new, "off the floor" screen-trading system, by SAMA. This scheme will allow greater liquidity in the market.

---

Also through SAMA, the Kingdom is playing an important role in the IMF and the International Bank for Reconstruction and Development (IBRD). One benefit of the link with the IMF is the control of the foreign exchange value of the riyal, through the IMF special drawing rights (SDR’s).

However, as regulator and controller of administration, SAMA is expected to play a significant role in the privatisation programme. The depth of this participation will depend on SAMA’s role as an investment agency acting on behalf of the government in both promoting banking and investment activities in general, or representing the government in privatisation deals, especially with respect to “golden deals” or state shares in proposed projects.

**Credit Institutions:**

Credit institutions are not a luxury but an essential pre-requisite for the financial and economic development of any country, especially of one where the private sector is being encouraged to take on additional economic responsibilities. This is especially true for those countries where the dominant role of the state in economic and corporate life is gradually being diminished and there are plans for selling-off state companies as in the case of Saudi Arabia. In theory the private sector should have adequate finance to buy large government enterprises. But this is not necessarily the case every time, therefore funds must be available as a logical step forward to ease privatisation.

Since 1971, the Saudi Arabian Government has set up specialized financial institutions to lead Saudi business in productive activities. These are mainly:
A. The Saudi Arabian Agricultural Bank which was founded on 1963 and provides loans for investment in agricultural projects, machinery, vehicles, food stock and live stock.

B. The Saudi Industrial Development Fund which was set up in 1974 with an initial capital of SR 3 billion, about $900 million. The objective was to encourage Saudis in the private sector to establish a small and medium-scale industrial base. Projects receiving support have typically fallen into three categories: construction and construction materials, industrial and manufacturing processes, and preparation of consumer goods including food processing. In addition to loans to cover up to 50 percent of a project’s total capital costs, the fund provides marketing, technical and financial advice.

In the first five years of SIDF’s operations, about 15 percent of funds disbursed went to joint venture activities in which foreign as well as Saudi interests were involved. Joint venture activities are viewed as important vehicles for raising the technical and commercial expertise of Saudi entrepreneurs.

C. The Real Estate Development Fund was set up in 1974 to provide long-term interest-free loans to individual citizens; up to SR 300,000 is available for the construction of a home. Loans are granted on proof of ownership of a plot of land. The fund also offers loans for large scale real estate projects. In the first six years of operation, the fund made loans amounting to SR 32 billion.

D. The Saudi Credit Bank: This bank provides interest-free (usually short-term) loans to low-income Saudi citizens. Loans are intended to be obtained
for a limited number of specific purposes such as marriage and house renovation.

E. The Public Investment Fund was established in 1970 with an initial authorized capital of SR 1 billion to provide a vehicle for government participation in commercial ventures undertaken by the private sector. Some of the major beneficiary organisations are Saudi International Airlines and the Saudi Basic Industries Corporation (SABIC). In general, the examination of the nature of these fund activities indicates that their support is directed to achieve economic diversification and productivity; distribution of wealth; and encouragement of investment. Such important objectives happen to be essential components of the newly advocated privatisation package. This may imply that the services provided by those funds will be needed even more in the future to strengthen private sector investment capacity in development projects and further participation in the privatisation programme.

As a result of their early support, industrialisation in Saudi Arabia has been progressing at a very rapid pace in the past, yet -

"The Saudi industrial sector may need close to $10 billion in project finance over the coming years. This is over and above the $ 1.3 billion that has already been committed ($500 million for Hadeed and $300 million for Ibn Sina among other small projects). Commercial banks will be asked to provide at least half of this amount with the remainder coming from shareholders and to a lesser extent from the Public Investment Fund or the Saudi Development Fund". (1)

This indicates that 1) the scope of industrialisation activities is broadening all the time as a result of the linkages, technologies and services introduced, 2) the advancement of the industrial sector will be the most promising leading factor in economic growth 3) the private sector is being called upon to play a pivotal role in financing future development. However, the participation of the private sector in financing industrial projects is not a completely new development.

"Many industrial development initiatives are not exclusively of government origin. In 1984, the National Industrialisation Company (NIC), a private sector initiative with government support, was established, and has since then invested in 45 companies across a spectrum from aircraft repair companies to glass manufacturers and canning companies. NIC provides start-up capital, invests in existing industries, and creates industrial service and support projects in the private sector. The company has lined up 10 major projects totalling SR 2 billion ($533 million) over the next four years". (1)

With respect to small businesses, which cover around 1569 enterprises across the Kingdom, they are expected to rely on commercial banks for their loans & finance. According to Henry T. Azzam, the Chief Economist of National Commercial Bank (NCB), credit extended to industry continued to play a minor role in overall commercial bank lending activities. It dropped to 5.5% of the total in 1989 before rising to 7.7% in 1990, and dropping again to

---

6.7% in 1992. Small firms' share of local bank lending to the industrial sector did not exceed 20% or SR 1.5 billion in 1992.\(^1\)

This is attributed to various factors including lack of equitable standards of protection for creditor banks in case of default; and smaller firms in Saudi Arabia, like elsewhere, tend to have a higher rate of business failure. It is generally observed that most of the owners of small enterprises in the Kingdom do not even have the appropriate expertise in all aspects of business and rely nearly entirely on the technical and managerial skill of their foreign counterparts or their expatriates. This puts them in a disadvantageous position when presenting their case for finance or when convincing the lending institution of the economic viability of the project or their credit worthiness.

Besides that, most small businesses in the Kingdom do not maintain accounting, sale, purchases, cash and payroll records. Furthermore, they do not prepare annual budgets nor do they keep an independent bank account under the name of the establishment.\(^2\)

In the agricultural sector, however, Saudi Arabia has been among the world's fastest growing food producers, with GDP in the agricultural sector recording an average annual growth rate of 8.1% during the period 1980-1985 and 13.4% in the period 1985-1990.\(^3\)

In the Fifth Development Plan (1990-1995) agriculture's share of GDP is expected to grow to 9% by 1995 achieving an average annual growth rate of

---

7% in value added. This development is a direct result of the government support for the agricultural sector and subsidies.

"Direct agricultural subsidies from the government budget grew at an annual average rate of about 9% during the 1984-1987 period to SR 6.9 billion ($1.84 billion), before declining sharply to an average of SR 4 billion ($1.07 billion) during 1988-1989 as the provision of subsidies was curbed in light of budgetary constraints. However, subsidies were on the rise again in the last two years reaching SR 7.95 billion ($2.12 billion) in 1991". (1)

Most of this agricultural support is provided by the Saudi Arabian Agricultural Bank which provides interest-free loans to farmers mainly for purchase of farm machinery and drilling of wells. Total loans extended by the bank since its inception in 1964/65 reached SR 25,728 million ($6,861 million) by the end of 1991.

However, in view of the government's policy which emphasizes rationalization and reduction of subsidy rates, it is anticipated that there will be a shift towards domestic borrowing in the private sector to finance further investment in the Agricultural Sector and other sectors of the economy.

During the Fifth Development Plan (1990-1995) specialized credit institutions are expected to provide approximately SR 35 billion investment by recycling repayments of outstanding loans while the private sector is expected to contribute about SR 144 billion of total investment. Financing of this investment will come primarily from retained earnings of private sector

---

companies, private saving, commercial bank loans and private capital brought back from overseas. (1).

This carries a significant change in both policy direction and ultimately the structure of expenditure and consumption of the Saudi economy. This change will have an impact on directing privatisation to the more productive sectors of the economy rather than government services. The latter will be left to the state as part of its investment expenditures. This will be financed by development bond issues, if needed.

**Commercial Banks**

The major domestic money market institution in the Kingdom is the commercial banking system. This section provides an assessment of how the Saudi commercial banking system is responding to the problem of growing competition and the future need of both domestic investment and privatisation.

During the last three decades, and especially after the year 1973 which witnessed the increased flow of oil revenues and the infusion of new capital into the commercial banking system, the banking services have rapidly developed and expanded. This development encompasses not only the increase in the number of bank branches and growth of assets, but also the increasing sophistication and scope of services offered. There are currently 12 major banks and the number of their branches reached 1980 by the end of 1993. In the context of this development, an important question arises. Has the banking system been a major source of support to the private sector?

---

We shall begin to seek the answer by examining the scope of this support to the private sector. According to SAMA’s annual report for 1990, commercial banks’ claims on the private sector (loans and advances, bills discounted and investments in private securities) registered a fall of RS. 8.0 billion or 10.9 percent during 1990, as repayment of outstanding loans exceeded the amount of fresh loans. The amount of fresh loans granted during 1990 was smaller than in 1989 as indicated in table (2.1), reflecting weak demand for bank funds and a more cautious attitude on the part of banks in granting loans.

Table - 2.1

<table>
<thead>
<tr>
<th>BANKS’ CLAIMS ON THE PRIVATE SECTOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>(At the end of fiscal years)</td>
</tr>
<tr>
<td>(Amounts in Million Riyals)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount % share</td>
<td>Amount % share</td>
<td>Amount % share</td>
<td></td>
</tr>
<tr>
<td>Loans and advances</td>
<td>66,617 94.5</td>
<td>68,544 93.5</td>
<td>59,941 91.8</td>
</tr>
<tr>
<td>Secured loans</td>
<td>31,942 45.3</td>
<td>25,138 34.3</td>
<td>25,798 39.5</td>
</tr>
<tr>
<td>Unsecured Loans</td>
<td>33,501 47.5</td>
<td>42,334 57.7</td>
<td>33,114 50.7</td>
</tr>
<tr>
<td>Import L.C. advances</td>
<td>1,174 1.7</td>
<td>1,072 1.5</td>
<td>1,029 1.6</td>
</tr>
<tr>
<td>Bills discounted</td>
<td>791 1.1</td>
<td>725 1.0</td>
<td>855 1.3</td>
</tr>
<tr>
<td>Investment</td>
<td>3,115 4.4</td>
<td>4,012 5.5</td>
<td>4,500 6.9</td>
</tr>
<tr>
<td>TOTAL</td>
<td>70,523 100.0</td>
<td>73,281 100.0</td>
<td>65,296 100.0</td>
</tr>
</tbody>
</table>


However, as of January 1990, commercial banks’ claims on the private sector assumed a rising trend and recorded a rise of SR 5.8 billion or 9.0 percent over the first half of 1991. This could be attributed to the revival of private sector confidence and activity following the successful conclusion of the Gulf War. (1)

1 - Saudi Arabia Monetary Agency (SAMA): Annual Report 1990, p.52
According to Henry T. Azzam, banks in general are reporting good results for the year 1993 too, showing both higher assets and larger profits. Total commercial bank credit reached SR 117.7 billion in the first half of last year, up 10% on the same level a year ago. Manufacturing, utilities, agriculture, construction and the government sector recorded an increase in commercial bank credit, as illustrated in table (2.2).

Table - 2.2

COMMERCIAL BANKS’ CREDIT BY ECONOMIC ACTIVITY 1991-1993 (SR million)

<table>
<thead>
<tr>
<th>Economic Activity</th>
<th>1991</th>
<th>% Charge 91/90</th>
<th>1992</th>
<th>% Charge 92/91</th>
<th>1993 (1st Half)</th>
<th>% Charge 93/92*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Fishing</td>
<td>1,604</td>
<td>34.4%</td>
<td>2,071</td>
<td>29.1%</td>
<td>3,879</td>
<td>61.4%</td>
</tr>
<tr>
<td>Manufacturing &amp; Processing</td>
<td>6,324</td>
<td>23.0%</td>
<td>7,294</td>
<td>15.3%</td>
<td>9,833</td>
<td>35.4%</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>449</td>
<td>77.4%</td>
<td>514</td>
<td>14.5%</td>
<td>316</td>
<td>-43.2%</td>
</tr>
<tr>
<td>Electricity, Water &amp; Other Utilities</td>
<td>945</td>
<td>42.3%</td>
<td>1,892</td>
<td>100.2%</td>
<td>1,623</td>
<td>69.2%</td>
</tr>
<tr>
<td>Building and Construction</td>
<td>10,744</td>
<td>-2.3%</td>
<td>11,985</td>
<td>11.5%</td>
<td>13,778</td>
<td>13.3%</td>
</tr>
<tr>
<td>Commerce</td>
<td>14,829</td>
<td>0.8%</td>
<td>20,160</td>
<td>35.9%</td>
<td>16,064</td>
<td>-11.5%</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>5,758</td>
<td>7.5%</td>
<td>5,714</td>
<td>-0.8%</td>
<td>4,789</td>
<td>-19.7%</td>
</tr>
<tr>
<td>Finance</td>
<td>13,103</td>
<td>37.5%</td>
<td>15,364</td>
<td>17.3%</td>
<td>11,639</td>
<td>-20.2%</td>
</tr>
<tr>
<td>Services</td>
<td>7,252</td>
<td>68.5%</td>
<td>7,876</td>
<td>8.6%</td>
<td>7,791</td>
<td>-16.9%</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>23,847</td>
<td>58.9%</td>
<td>35,072</td>
<td>47.1%</td>
<td>48,009</td>
<td>35.3%</td>
</tr>
<tr>
<td>Total</td>
<td>84,855</td>
<td>26.4%</td>
<td>107,942</td>
<td>27.2%</td>
<td>117,721</td>
<td>10.1%</td>
</tr>
</tbody>
</table>

* First half 1993 compared to first half 1992.

Source: SAMA Quarterly Bulletin, 3rd Quarter.

The significant aspect of this support, however, is that it is more concentrated on the productive sectors of the economy than services, and that the private sector activities are booming due to this support.

In the past, loans to business were primarily short term because 90 percent of their financial base was in short term liquid deposits, yet as indicated in table (2-2) banks are providing finance for areas like mining or manufacturing which by nature of their business would require longer arrangements to their

loans. The implication is that local banks had to make necessary changes in their statutory structure to accommodate this new trend and any future investment requirements which call upon their resources, and that commercial banks, began to respond to this development.

Commercial bank owned credits are expected to surge more in the future as the autonomous government institutions will be borrowing to finance their expansion plans, and also contractors and suppliers will draw more on bank facilities to finance account receivables on delayed government payments.\(^{(1)}\).

Therefore, because there are demands for increasing availability of medium to longer term finance in the private sector particularly, the Fifth Development Plan (1990-1995) is urging the establishment of specialized banks or financing companies, owned by the private sector, that will issue bonds on the capital market to cover the long term finance-needs of industrial, commercial and business enterprises. This would require some changes in the banking supervision system, particularly with respect to allowing bank participation in the capital of other companies and banks. \(^{(2)}\)

This participation will allow banks to play a leading role as institutions in the ownership and management of proposed projects for privatisation.

**Stock Market**

A stock market facility is a very important constituent for any privatisation programme. In fact, one of the selling points for privatisation is the development of the capital market in the broader sense, through which

---

resources can be generated, raised and mobilized. Another benefit of the stock market is that it creates new opportunities for privatisation.

As intermediary financial institutions, stock markets generally provide advisory, underwriting, marketing functions as follows:

1. The advisory function consists of supplying information as to the kind of securities, preparation of the issuing prospectus, the price of securities and the time most conducive to their sale.

2. The underwriting function consists of the purchase of shares by banks and their resale to investors. The banks assume the sales risk. The banks charge a fee or spread for the sale of shares, equal to the difference between the price demanded by the issuers and the sum paid by investors.

3. Marketing entails promotion and sale of securities by the banks’ domestic and foreign branches. (1)

In Saudi Arabia, there is no “Stock Market” institution as such, instead, share trading transactions are carried out through the 12 commercial banks and their branches. The day-to-day security trade monitoring and control is implemented through a share-control administration division (SCAD) which operates under the auspices of SAMA. In 1985, the commercial banks jointly formed the Saudi Share Registration Company (SSRC). All brokerage activities were confined to the new company which created a Central Unit to co-ordinate the buying and selling of shares through bank branches. Banks are

---

not allowed to take positions in stocks. The central unit serves also as a clearing system after trades are executed.

The maximum commission was fixed at 1% for all size dealings and is shared equally by the buyer and seller. The mechanism of share transaction is as follows:

Those wishing to buy or sell shares in the market would approach a bank’s branch and complete an application form indicating amount and preferred prices. Buyers would have to make the payment in advance. Banks would try to match buyers and sellers first within their own branch network and then with the central coordinating unit of other banks through a clearance office at SAMA. Forward dealings and the acceptance of post dated checks are prohibited and banks are responsible for the settlement of shares. Publicly traded companies would have to publish quarterly financial statements in the local press and banks could charge a maximum of 1% of the value of the shares traded, split between both the buyer and the seller.

As mentioned earlier, the new “off the floor” screen trading system, the Electronic Securities Information System (ESIS), is a strictly computerized dealing scheme which will allow greater liquidity in the market. Generally, the transactions take place under perfect market conditions in that:

1. Share-holders have freedom to borrow or lend (invest) or buy and sell shares.
2. Share-holders have free access to financial information.
3. Share-holders can invest in other companies of equivalent relative risk in order to earn the required rate of return.
The stock market activities in Saudi Arabia have increased substantially during the last decade. The number of companies whose shares were traded in the Saudi stock market in 1993 reached 61.

The ownership of shares in those joint stock companies is divided among government, banks, and individuals as can be seen in the table:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Government &amp; Public Sector Institutions</th>
<th>Banks &amp; Retirement Funds</th>
<th>Foreigners</th>
<th>Individuals</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>0.1</td>
<td>3.4</td>
<td>39.4</td>
<td>57.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Industry</td>
<td>15.0</td>
<td>7.5</td>
<td>5.8</td>
<td>70.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Services</td>
<td>71.3</td>
<td>3.6</td>
<td>-</td>
<td>25.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>6.3</td>
<td>6.7</td>
<td>-</td>
<td>86.7</td>
<td>0.3</td>
</tr>
<tr>
<td>Total market</td>
<td>54.1</td>
<td>4.5</td>
<td>2.9</td>
<td>38.2</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: A. Al-Dukheil, Al Iktissad Wal Aamal / Special issue Sept. 1992

From the table it appears that 38% of the shares of these companies are held by individuals and available for trading, the rest are held mostly by government and foreign entities holding mainly bank shares and most of these shares are not traded. This structure reveals (a) a concentration of ownership of shares in the hands of individuals and trading families, as business in Saudi Arabia is mostly family-business oriented, (b) a large chunk of Saudi shares still under public sector control. The main point in this regard is that the percentage of government ownership of shares in the banking and the agricultural sectors is very small indicating the possibility of full privatisation of these two sectors before any other sectors, as most of this business is already in private hands.
However,

"Saudi Arabia has the largest Stock Market in the Arab World in terms of capitalization; but is likely to remain closed to foreign investors". (1)

And shares are normally acquired by Saudi citizens, except in special cases, such as the 1984 SABIC issue when specified portions were made available to GCC citizens.

Recently, the Arab National Bank was given the green light to launch the first fund for local investment, with around 30% to be placed in Saudi shares. Non-Saudis could invest in this fund and other banks in the Kingdom may be allowed to launch similar funds in the future.

Based on the stock-market activities the following were generally observed:

1. The increasing activity in share purchases & trading generated some concerns that the market is rising too quickly.
2. And consequently, the Saudi stockmarket has been transformed from a vehicle for long term investment to a channel for generating short term profits. The speed and scale of the upward move in prices have led to concern that the market might be overheating and many are worried that Saudi shares have become overpriced at current levels (2).
3. Non-Saudi investors are almost entirely excluded from the market.
4. Lack of adequate information for investors.

Therefore, some form of a correction may take place which could prove beneficial for the market in the long-run. In this context it is recommended

---

that the new computerized trading system introduced by SAMA in 1990 should be expanded so that banks all over the Kingdom will be linked by a computer network with the Saudi Shares Registration Company and with the central coordinating and clearing unit at SAMA. This will eliminate delays caused by transferring documents by mail and render the market more efficient. If well executed, such a system of “over the counter” trading would be a viable substitute for a central trading floor.

There is also a need to provide or to improve the quality of information and ensure its systematic availability. Such steps are essential for both privatisation and the development of the financial sector itself which is expected to have an average annual growth rate of 6.6% in the Fifth Plan period.

The Fifth Development Plan which emphasises the role of the private sector in financing the future development of the Saudi Arabian economy calls upon the commercial banks to increase the availability of long term loans through the establishment of specialised banks or financing companies owned by the private sector; these will issue bonds on the capital market to cover the long-term financial needs of industrial and business enterprises. In addition, consideration will be given to the establishment of a more effective stock exchange with appropriate state regulation and control. Such an active development will enhance economic growth through: stimulating the supply of stock capital to business enterprises, opening greater opportunities for public participation in ownership, expanding domestic savings and investment, and consequently enhancing the promotion of privatisation activities.
Chapter Three

The Economy and Economic Development
The main purpose of this chapter is to provide the economic background for privatisation in Saudi Arabia by examining economic problems, performance and development policies. Such a discussion within the narrow field that it covers, seems essential in order to see from what point of view and on what basis Saudis are embarking on privatisation.

Thus, the transformation of the Saudi Arabian economy from a one commodity economy to one more diversified, the commitment to free trade, the theme and context of development plans, the down turn in the economy including deficit in the budget and manpower shortages are issues that are brought together in the following discussion to reflect the capacity of the economy for change and to demonstrate that the balance of such issues depends upon factors in the state-tradition which may not be applicable elsewhere.

**The Economic Problem & Background**

Like every society, Saudi Arabia faces some basic problems of economic organisation. The essence of the economic problem in Saudi Arabia lies in the fact that the major source of income is only one commodity-oil. But oil is a depletable resource, with time it will be exhausted, and therefore alternatives must be found to ensure economic continuity and stability.

For many years, returns from oil were the real vehicle behind modern development in Saudi Arabia. And because the government has the overall control of this resource, it plays, consequently, a potential role as a consumer and as a subsidiser of consumption. This is demonstrated through direct expenditure on consumption and on large scale investment, as well as the provision of loans and other financial assistance to other agents in the
economy. While the government's expenditure on consumption (health, education and defense) is quite large, a large part of its economic activity is directed at encouraging economic growth, either by direct investment or by providing funds for enterprises which contribute to economic growth.

Secondly, because the generated income is far larger than the absorptive capacity of the market at one time, Saudi Arabia devoted extra resources to helping poorer countries. This was a reasonable choice in certain given circumstances; the problem is that such a commitment is becoming more "obligatory" rather than "voluntary".

The third aspect is manpower shortages in both a quality and quantity sense. Despite the huge expenditure on both education and training, many problems associated with manpower still exist, such as lack of technically skilled workers, inefficiency, and disorganisation. In other words, an important factor of economic growth is not fully utilized.

However, the most demanding and persistent economic problem that Saudi Arabia is currently facing is "budgetary deficit". This is attributed to many factors including heavy expenditure on development projects, fluctuations and uncertainties of the international oil market; and the involvement of the Kingdom in the neighbouring Iraq-Kuwait war in 1990. The costs of the first five months of the Gulf crisis out-weighed additional revenues from higher oil production and prices resulting in a deficit of SR 55,709 million ($14,856 million). The impact of the war crisis led to a similar deficit in the 1991 budget which amounted to SR 77,000 million or almost 20 percent of GDP.

The implication of this problem has already been seen and felt. The immediate result was a growing public sector borrowing requirement with its associated
increased interest rates. For the first time, the government resorted to direct borrowing to finance the 1991 deficit. The government raised a total of $7,000 million of which $4,500 million was through internationally syndicated loans and $2,500 million from local banks. The rest was financed by increased sales of government development bonds. Bond sales are estimated at SR 41,000 million in 1990 and SR 50,000 million in 1991.

Also, the Saudi Arabian government encourages state-owned companies to raise their own finance through commercial loans to reduce their demands on the exchequer. Examples include the electricity utility SCECO-West which raised $32,000 million in mid 1991, and Saudi Aramco which raised loans totalling $2,900 million in 1992.

"The government can continue for sometime to finance its expected budget deficits through domestic borrowing. The question is whether this is to be just a short-term solution, or whether the government will do anything to put its financial house in order so that it can genuinely achieve major cuts in its now routine budget deficits". (1)

In 1994, Saudi Arabia responded to this problem by making the biggest spending cut, slashing expenditure by around 20 percent to $42.6 billion from $52.5 billion in 1993. This pushed the projected deficit down to $1.25 billion from $7.42 billion. Moreover Saudi Arabia is expected to embark on an ambitious privatisation programme to finance the budgetary deficit.

---

Economic Policy & Objectives

The major objective of Saudi Arabia's economic policy is economic stability and growth. In line with this objective there are other long term goals which have guided national development over the past twenty five years. Those are:

- Economic diversification.
- Raising living standards and improving quality of life.
- Maintaining economic and social stability.
- Regional development.
- Strengthening the role of the private sector in the economy.
- Broadening the linkages between the Kingdom and other nations.
- Developing and completing the physical infrastructure.
- Developing human resources. (1)

The government has emphasized in particular "Economic Diversification" as an important fiscal policy in shifting towards productive investment and the development of a free market economy based upon private rather than public enterprise. The diversification strategies have led to positive structural change of the economic base resulting in marked progress in the agricultural sector and the creation of new heavy hydrocarbon-based industries. Therefore dependency on the oil sector has gradually eroded.

"As consequence, the public sector is likely to have less importance by 1995, while the producing sectors should increase their share of non-oil GDP to 43% compared with 37% in 1985. Manufacturing is expected to contribute over 14% of non-oil value added by 1995 compared with 11.9 in 1985. The construction sector is forecast to grow, maintaining its share of non-oil GDP

---

1 - Ministry of Planning: The Fifth Development Plan, pp. 4 - 5
of around 16% with an underlying value added. Real growth of 38% per annum after a long period of decline. This reflects a planned upturn in investment and reconstruction. The trade sector will decline in importance as import substitution occurs and the finance sector should comprise over 7% of non-oil GDP by 1994". (1)

Table (3.1) illustrates the composition of Gross Domestic Product over the period 1989-1994 at current prices. It indicates the declining contribution of the oil-sector by comparison to other productive sectors of the economy.

Table - 3.1

COMPOSITION OF GROSS DOMESTIC PRODUCT 1989-1994
At Current Prices

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in current Prices (SR billion)</td>
<td>304.1</td>
<td>385.0</td>
<td>424.9</td>
<td>446.0</td>
<td>450.5</td>
<td>442.9</td>
</tr>
<tr>
<td>Composition of GDP (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil Sector</td>
<td>28.9</td>
<td>38.0</td>
<td>37.1</td>
<td>37.1</td>
<td>35.1</td>
<td>34.8</td>
</tr>
<tr>
<td>Non-Oil Sector</td>
<td>70.2</td>
<td>62.0</td>
<td>62.9</td>
<td>62.9</td>
<td>64.9</td>
<td>65.2</td>
</tr>
<tr>
<td>Private Sector</td>
<td>42.8</td>
<td>36.1</td>
<td>34.9</td>
<td>35.2</td>
<td>36.6</td>
<td>38.8</td>
</tr>
<tr>
<td>Government Sector</td>
<td>27.4</td>
<td>25.9</td>
<td>28.0</td>
<td>27.7</td>
<td>28.2</td>
<td>24.8</td>
</tr>
</tbody>
</table>


This change of policy and development, as a whole, indicates a structural change in the economy from growth based on public sector initiative to one where the private sector takes the lead.

In overall terms, the progress in the private sector was made possible due to: government support including market protection, subsidies, technical aid,

---

exemption from customs fees, land and services; the commitment to a high level of capital expenditure resulting in a massive increase in demand to which the domestic private sector, in partnership with foreign companies, responded; the completion of physical infrastructure facilities which supported the whole business environment.

The Fifth Development Plan 1990-1995 emphasized that the private sector is the corner stone of economic diversification. A net inflow of private capital from abroad and within the Kingdom will be stimulated to engage in development projects and increase the level of foreign direct investment in the Kingdom. Broader trade links outside the oil sector will also be forged, particularly with other GCC countries. Moreover, privatisation of some government projects will be undertaken with the intention to increase their economic effectiveness.

Development of domestic financial markets also occupies special importance to facilitate investment objectives and to promote the participation of the private sector in financing development. 

**DEVELOPMENT EXPERIENCE (An Overview)**

Saudi Arabia has now nearly twenty-five years of planned development experience i.e. 1970-1995. On August 16, 1970 the Kingdom announced its First Development Plan for the five-year period 1970-1975. This plan was originally prepared under a climate of financial constraints. The plan was designed to increase the rate of economic growth, develop the Kingdom's natural resources and improve social welfare.
The progress ever since is outstanding in view of the initial obstacles that the country had to surmount; a severely underdeveloped physical infrastructure, serious shortages of managerial and technical know-how and the dominance of oil as the only source of national income.

"During the past 20 years national income has increased more than fourfold in real terms, reaching a value of SR 280 billion in 1409. Personal consumption - perhaps the best measure of living standards - has increased at an annual rate of 9.4 percent in volume terms. Infant mortality has dropped from 148 per thousand live births in 1390 to about 43 currently. The number of physicians in the Kingdom has grown from 1,200 in 1390 to more than 2,000 in 1409, while the number of hospital beds has increased from 11,000 to over 38,000. The real output of the private sector has grown fivefold in volume terms during the past 20 years. Private investment has increased sevenfold in real terms. And employment in the private sector has increased by 3.9 million."

At the beginning of the Fifth Development Plan 1990, Saudi Arabia had diversified its exports and become one of the world’s largest exporters of petrochemicals, with a value of over SR 10 billion, which accounted for 11 percent of total exports. Private investment had increased seven fold in real terms; employment in the private sector had increased by 3.9 million; ports had been modernized and more than 163 new berths had been added; desalination plants increased their water output up to almost 1,500,000 cubic meters per day; and seven universities and eleven girls colleges had been established, with a current enrollment of more than 120,000 students.

---

2 - Ministry of Planning: The Fifth Development Plan, pp. 7 - 8
By 1993, there were 2,036 factories operating in the Kingdom with a combined investment of SR 139 billion ($37 billion), employing more than 175,000 workers and generating annual sales of SR 50 billion ($13.3 billion). The largest amount of capital was invested in plants producing chemical and plastic products (60%), followed by building materials (15%), metal products and equipment (9%), food and beverages (7%) and plant producing textiles, transport equipment, wood products and other consumer goods (9%), indicating positive growth of private sector activities.\(^1\)

**Theme & Context of Development Plans**

The main feature of the Saudi national development planning is “continuity and consistency”. This is in fact the heart of the whole development process. Each development plan has its own focus and strategic directions for future growth. Yet each development plan does not represent a sharp change in policy and commitment. This concept is illustrated in figure (3.1) which shows the focus of every individual plan. The examination of both the development process and the objectives of the development plans indicates that there is a deliberate attempt in such strategies to be comprehensive and build on success gradually and consistently. Thus “continuity and consistency” can be considered as built-in elements in the overall economic strategy of Saudi Arabia.

The focus of the **First Development Plan** (1970-1975) was on revenue maximisation and economic growth. This was a natural response to the kinds of problems and circumstances which were predominant during the plan initiation. But things have drastically changed following the 1973 oil

---

Figure (3.1)

THEMES OF THE SAUDI ARABIAN DEVELOPMENT PLANS

Economic Strategy

1st Development Plan
1970 - 1975

Revenue Maximisation

2nd Development Plan
1975 - 1980

Development of Physical Infrastructure

3rd Development Plan
1980 - 1985

Economic Diversification & Human Resources Development

4th Development Plan
1980 - 1985

Economic Diversification, Rationalisation of Subsidies, and Operation & Maintenance

5th Development Plan
1990 - 1995

Privatisation & Intensification of Structural Change

6th Development Plan
1995 - 2000

Stability of Growth

Characteristics

CONTINUITY & CONSISTENCY
crisis. This led to a steep increase in the level of government revenues. The real gross value contributed by the oil sector rose sharply during the period 1970-1974 from SR 6 billion to SR 20 billion representing an average annual growth rate of 20 percent.

By the time the Second Development Plan (1975-1980) was introduced there were abundant financial resources available in the Kingdom. This assisted Saudi Arabia to focus and build an adequate physical infrastructure base which was very critical in order to facilitate future growth and the economic development of the regions of the country. The scale of development was massive both in terms of expenditure and construction. Total plan allocations amounted to SR 700 billion, almost a nine-fold increase over the first plan. The following table illustrates allocations for different development plans covering the period 1970-1995.

Table - 3.2

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>EXPENDITURE Value (SR billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Development Plan</td>
<td>89.0</td>
</tr>
<tr>
<td>Second Development Plan</td>
<td>700.0</td>
</tr>
<tr>
<td>Third Development Plan</td>
<td>782.7</td>
</tr>
<tr>
<td>Fourth Development Plan</td>
<td>324.1</td>
</tr>
<tr>
<td>Fifth Development Plan</td>
<td>498</td>
</tr>
</tbody>
</table>

* Based on information gathered from Development Plans
As a result of the intensity and magnitude of development during the second plan, certain problems have emerged. Among these were problems of manpower supply and demand including a continuing imbalance between the economy’s growing manpower requirements and the number of new Saudi entrants into the labour force. There was a concentration of demand for non-Saudi labour in the private services sectors. On the other hand, there was a very high level of demand for goods and services and excessively high contract prices which contributed to other problems of strong inflationary pressures, and the congestion of the ports with ships waiting times reaching 120 days on occasions.

However, several corrective measures to control this situation were introduced especially to halt and control the inflationary pressures. These include; price control in the form of fixed retail prices; increased subsidies on essential supplies; and consumer protection. Also the government introduced a monetary policy, by which the annual expenditure budgets were consolidated at exactly their 1976-1977 nominal level of increase for the following two years, with only a minimal increase in 1978-1979. The unchanged cash totals meant that inflation was absorbed at the expense of some economic growth.\(^1\)

The Third Development Plan (1980-1985) is noted for its focus on Economic Diversification and Human Resources Development. There was a significant shift away from expenditure on physical infrastructure towards the development of the producing sector of the economy. This is illustrated in table (3.3) which shows also the breakdown of the total government expenditure on civilian development, administration and subsidies.

\(^1\) - Ministry of Planning: The Third Development Plan 1980 - 1985, p. 47
Table - 3.3
Total Government Expenditure on Development
1980-1985

<table>
<thead>
<tr>
<th>Function of Expenditure</th>
<th>SR billion current Prices</th>
<th>2nd Plan (2) Percent</th>
<th>3rd Plan Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Resource Development</td>
<td>261.8</td>
<td>25.1</td>
<td>37.3</td>
</tr>
<tr>
<td>Human Resource Development</td>
<td>129.6</td>
<td>15.9</td>
<td>18.5</td>
</tr>
<tr>
<td>Social Development</td>
<td>61.2</td>
<td>9.4</td>
<td>8.7</td>
</tr>
<tr>
<td>Physical Infrastructure</td>
<td>249.1</td>
<td>49.6</td>
<td>35.5</td>
</tr>
<tr>
<td>Sub-Total Development</td>
<td>701.1</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Administration (3)</td>
<td>31.4</td>
<td>6.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Emergency Resources and Subsidies</td>
<td>49.6</td>
<td>15.9</td>
<td>7.1</td>
</tr>
<tr>
<td>Total Civilian Expenditure</td>
<td>782.7</td>
<td>122.6</td>
<td>111.6</td>
</tr>
</tbody>
</table>

NOTES:
1. The total exclusive: i) transfer payments; ii) non-civilian sectors; iii) foreign aid.
2. Based on actual and estimated values converted into 1979-1980 prices.

Source: Ministry of Planning Summary of Saudi Arabian Third Five Year Development Plan, P-25, Published in 1981. TIHAMA.

The emphasis on economic diversification sign-posts the beginning of a shift towards private sector initiative and participation, and ultimately privatisation. This policy has ever since been pursued consistently resulting in better consolidation of resources and development of the private sector.

The Fourth Development Plan (1985-1990) was prepared and introduced in a much harsher economic climate. This situation necessitated the re-emphasis of the fundamental long term goal of economic diversification and development of the more productive sectors of the economy. Also the plan emphasised the importance of the internal efficiency of the economy as a whole with special focus on operation and maintenance and rationalization of subsidies.
However, the fiscal pinch was already being felt during the plan period with the down turn in the economy reading its lower points in 1987 and 1988. This immediately led to a deficit in the balance of payments and sharp reduction in development expenditure. For example, expenditure on transportation and communication was about two thirds of that planned. Economic resources, municipalities and housing suffered the largest cuts losing about 50 percent of their planned level.

The government implemented a wide range of policies, among which was a major budgetary initiative, namely the issue of government development bonds. Such a step entitled The Ministry of Finance and National Economy to borrow up to SR 30 billion during the fiscal year, in order to meet the expenditure on development projects.

The offering of treasury bonds has served as a means of broadening and deepening the financial market. The new debt instrument provides a stable investment medium for local saving which encouraged the private sector to participate and finance development projects.

In general, The Fifth Development Plan (1990-1995) follows the goal of the Fourth Plan very closely, but with special emphasis on both the stabilisation of the economy through steady growth of government expenditure and the extension of the private sector role, not only as provider of services but as a lead-growth factor in financing development. This policy does not represent a major change in the economic strategy, but illustrates once again the key elements of “continuity” and “consistency” which distinguish the Saudi development process. The emphasis on the role of the private sector as lead growth factor has its own implication for the capacity of the financial market
as the private sector might resort to borrowing to meet the financial requirements for its participation and investment and on privatisation.

The Sixth Development Plan (1995-2000); strategic objectives were approved by the Council of Ministers in priority order as follows:

1. To continue supporting and enhancing the development of the Kingdom's defense capabilities.
2. To rationalize government expenditure and make the national economy more dependent on private sector activities.
3. To adopt the necessary measures for addressing the constraints which impede the development and employment of Saudi human resources.
4. Adopting appropriate means to achieve steady expansion in infrastructural facilities in line with the increased demand resulting from growth of population settlements.  

These objectives indicate the government is attempting to "maintain" or "stabilize" progress rather than "initiate" or "create" new developments. This can be justified on the basis of the following:

1. The economic hardship that Saudi Arabia is now experiencing necessitates scaling down future development.
2. In the past many projects and developments were achieved as a result of economic prosperity. These now require better maintenance or efficient utilization instead of creating new ones.

However, further examination of these objectives shows in the first place that the government is continuing to put defense on the top of its priority

---

1 - Ministry of Planning: General Objectives and Strategic Bases of the Sixth Development Plan 1995 - 2000
expenditure. This might be understandable in the light of the massive geographical size of Saudi Arabia and the recent experience of the Gulf War.

This policy, like almost everything else, has its own merits and de-merits. The possible advantages of this policy include: strengthening security and political stability of the Kingdom, increased opportunities for the private sector to supply the military with some goods and services, and massive spending on defense might force the government to seek alternative funds to meet the enormous military spending and hence embark on privatisation as an option to provide additional finance. However, privatisation should not be introduced for its own sake. There must be a clear set of objectives which are designed to achieve long term benefits rather than interim solutions.

This spending has recently become more investment-led through the offset programme. This programme requires that 35% of the value of specific contracts awarded to the principle contractor be re-invested in the Kingdom.

With regards to the potential dis-advantages of this policy, they are mainly that military spending is already squeezing the rest of the government budget, and will possibly continue to do so for many years to come until the Saudi Arabian armed forces are sufficiently large and experienced to fulfill their required role.

**The Saudi Development Experience and Privatisation**

The previous discussion presented a background to economic policy, nature of economic problems and theme of development plans in Saudi Arabia. Out of this presentation an important question arises: what is the significance of
this development to the introduction of privatisation in Saudi Arabia at this stage?

It seems that the answer to such a question lies in the nature and scale of this development. Our analysis will bring to the discussion points that have already been high-lighted. First, capital investment in development has been led mainly by the government, as the latter plays the role of consumer and subsidiser of production. This situation was inevitable as the government has overall control of the major source of income, namely oil, and in light of the absence of a strong private sector.

However, this situation is changing. Firstly, as a result of the enforced economic diversification policy, the private sector is assuming a more active and leading role in economic development. Such positive change eases the way towards privatisation.

Secondly, this extensive large scale involvement of the government in almost every sector of the economy created, with time, its own problems of administrative inefficiency, duplication, and potential waste of resources through schemes of relaxed subsidies. From the theoretical point of view, it is hoped that privatisation will be a contributing factor towards the elimination of some of these problems.

Thirdly, besides its material achievements in terms of infrastructural development, social development, introduction of modern technology and restructuring of the Kingdom’s productive resources, development experience as a function provided the conceptual vision to guide future plans and policies, and provided the organisational framework for coordination between the private sector and the public sector. This organisation, from a management
point of view, might facilitate the introduction of privatisation plans within the structure of the development process itself and the coordination element might, on the other hand, facilitate the transformation from the public to the private sector domain and control.

Fourthly, as mentioned earlier, one of the determining factors of the quality of Saudi Arabian development is "consistency". The question is how much influence this factor could have on privatisation. The previous experience indicated that this consistency ensured stability of development regardless of emerging problems such as fluctuations in the international oil market and consequent decline in income. It also has strengthened the socio-economic base through continued achievement. On this basis, it can be said that such a structure, whereby consistency is a built-in element, would provide a favourable atmosphere for privatisation - not only in terms of continuity and stability but also by the opportunity to build on success.
Chapter Four

Privatisation

Theory and Practice
This chapter is a review of related literature and a broad over-view of privatisation theories and practices upon which the general theme of this study is built. The essence of the problem lies in the fact that:

“Poor performance by the public sector goes a long way toward explaining the heightened interest in privatisation. It has forced the governments in both developed, developing, and even socialist countries to re-assess the role of the state in economic life.” (1)

Definition

According to Pirie, “privatisation is a comparatively new word. It made no significant appearance in political or economic literature before 1979.” (2) though according to Hemming and Mansoor, the word itself and the activities it describes go back to 1948 (3). “The word has been used in many different senses within the UK and in a large number of other countries and the meaning has thus gained many tinges. After sifting through as many as sixty definitions in as many sources this author (Wiltshire) believes the most comprehensive yet simplest is provided by Heald. He said that there have in fact been four separate components grouped under the term privatisation.

- Privatisation of financing a service that continues to be produced by the public sector (where charges rather than taxes should be used to finance public services).

---

• The privatisation of the production of a service that continues to be financed by the public sector (usually out of taxation), as in contracting out, education vouchers.

• Denationalisation and load shedding, meaning respectively selling of public enterprises and transfer of state functions to the private sector.

• Liberalisation, meaning relaxation of any statutory monopolies or licensing arrangements that prevent private sector firms from entering markets previously exclusively supplied by the public sector.” (1)

The above, are very much in keeping with other definitions like:

“Privatisation is the act of reducing the role of government, or increasing the role of the private sector in an activity or in the ownership of assets.”(2)

“To privatise is to render private. It is to place the activity or industry in the private sector or to transfer the ownership of an asset to private ownership.” (3)

At this stage, in the light of the fourth of Heald’s components above, it is appropriate to distinguish between privatisation and other terms that are alternatively used to describe the changing relationship between the public and the private sectors. Among the most important of these are deregulation and market liberalisation. While privatisation is about the change of property rights in national assets through sale of shares, deregulation can be made with or

3 - Cento Veljanovski: Selling The State - Privatisation in Britain, Weidenfeld Paperbacks, 1988, p xi
without privatisation aims for more economic-efficiency/price efficiency. On the other hand liberalisation is allowing the private sector to enter the market and to provide services which were previously, exclusively, supplied by the public sector. Liberalisation leads to the removal of market restrictions and aims to improve productive efficiency. Thus the relationship between privatisation and liberalisation is significant in the sense that gains in allocative efficiency (which is a function of market structure rather than ownership) can be expected only if privatisation is supported by liberalisation policies.

The Aims and Objectives of Privatisation

Usually, "There are both stated and unstated aims in any privatisation programme." (1) Vickers and Yarrow suggest that "a useful starting point for the analysis of political behaviour is the hypothesis that decisions are taken with a view to maximising the probability of electoral success." (2)

Privatisation involves the relationship between government, society and the economy and although many objectives may be clear and stated, others, as mentioned above, may be unstated and part of an unwritten political agenda—regardless of whether the government is subject to the ballot box or not. Fortunately, many objectives are well documented, such as:

A. To Increase Economic Efficiency.

"This is a fairly traditional objective of privatisation programmes everywhere." (3)

---

i. Property Rights / Principal Agent Theory

To a large extent unsuccessful public sector organisations continue to operate regardless of their finances whereas in the private sector they would cease to trade.

"There are substantial differences between private and public ownership of a firm that are conducive to greater efficiency under the former. The most obvious differences in the principal-agent relationship in case of public ownership is that the objectives of the public sector are different; shares are not marketable; and there is no direct equivalent to the bankruptcy and takeover constraint of financial performance. Governments do not typically seek to maximise profits. Rather it is assumed that they seek to maximise economic welfare ..." (¹)

The property rights theory is based on the argument that changes in the allocation of property rights alter the structure of incentives faced by firms' decision makers and therefore lead to changes in managerial behaviour and company performance. The central argument is that the shareholders as principals in the private sector have different objectives to the principal, the government, in the public sector. On privatisation, the new principals will set up an incentive structure for their agents (the management) different to the structure in the comparable government department/ministry under public ownership. As a result, both the allocative efficiency in the market - producing the maximum level of output given cost - as well as the internal efficiency of the firm - minimising the cost, given the level of output - will be altered. It is

assumed that in the private sector the rights to profits are clear and the firm will attempt to maximise profits of the shareholders. When performance is poor, shareholders, in theory, will sell their shares, possibly reducing the share price, and making the company vulnerable to take-over and new management.

Managers and directors may also be shareholders or benefit from profit sharing and stock option schemes, a further incentive to maximise profits. However, it must be stated that many managers and directors are salaried and may pursue objectives other than profit maximisation - sales maximisation for example - which may be in conflict. Wherever ownership and control are separated, management and shareholders objectives may not always coincide. This has to be balanced against government interference in public corporations where political imperatives such as maintaining employment levels or providing a level of service may be more important to the political master and where management may be constrained.

If management monitoring is assumed to be equally effective under both systems of ownership, it can be argued that public ownership has the advantage of correcting deviations in managerial decision making and setting appropriate incentive structures for managers. However, under public ownership information gathering to monitor managers’ performance is entrusted to a single body, whereas private ownership typically involves many specialists in the given task.
“Thus information gathering becomes more efficient under private ownership, hence may provide the more effective method of control, and assure a greater level of internal efficiency.” (1)

Indeed, although an integral part of the above, Kay and Thompson see one of the objectives of UK privatisation, for example, as “to resolve the persistent problems of management and control which have made the relations between government and management one of the unhappier elements of British public administration.” (2)

Efficiency and economic performance are not solely influenced by ownership. They also depend on the degree of competition in the industry and the regulatory constraints within which the firms operate.

ii. Competition

One of the principal objectives of privatisation in different nations is to stimulate competition and promote efficiency. In a different scenario to the UK, according to V. Klaus speaking as the Finance minister of Czechoslovakia the “introduction of the market economy is the most frequently heard rallying cry and slogan of the economic reform movements of the region” (3)

“It has been argued that, where increased efficiency follows privatisation, it results from a consequent increase in competition rather than a change in ownership.” (4)

1 - Fuat Andic: Privatisation - Theory and Policy, UNIDO, 1992, p 8
The central argument is that where a public enterprise is not subject to the rigours of free market competition, there is potential for gains in efficiency after privatisation in a free market economy. Discussion of privatisation of enterprises under different market conditions and where competition may be undesirable, takes place in Chapter 8 with specific reference to Saudi Arabia, but at its simplest, theory states that under perfect competition there is freedom of information, new firms can enter the market, firms have to innovate, and produce what the consumer wants at the competitive price. Production has to be at minimum cost or the enterprise will go out of business.

"Thus, the competitive process acts as a discipline for lethargic managers; it effectively regulates company behaviour; consequently is at the heart of much debate on privatisation policy." (1)

Under perfect competition, efficiency is maximised as firms are forced to produce at minimum cost (productive/technical efficiency) the lowest point on the ATC curve and consumers, through the forces of supply and demand, maximise utility as resources are moved to their most wanted uses as evidenced by consumers willingness to pay for final products, \( P = MC \), (allocative efficiency) as illustrated in Diagram -1

---

Hand in hand with competition comes the question of regulation.

"the economics of privatisation cannot be separated from the economics of competition and regulation" (1) and "regulation is an essential component of effective competition policy" (2)

The removal of barriers to competition do not necessarily lead to an increase in competition. Monopolistic enterprises in both the public and private sectors can set up price and non-price barriers. Therefore, an appropriate regulatory system is crucial. However, Mansoor and Hemming are sceptical as to the effectiveness of such regulation.

"the design and enforcement of regulations in the private sector have proved difficult......Often regulators do not have sufficient information to decide

---

whether a particular activity is anti-competitive. Moreover, once an anti-competitive practice has been identified, it may take so long to curtail that it will already have had its intended effects.” (1)

The success of private competition largely depends on the effectiveness of regulation.

In 1983 British minister John Moore pledged, as part of competition policy, that where state industries had been monopolies he “would break them up, or, as in the case of British Telecom, introduce competition with a regulatory structure to prevent them exploiting their former position in the market.” (2)

Over ten years on, it seems that Hemming and Mansoor had a right to be sceptical.

B. Financial Objectives

“In a number of countries, privatisation has been mentioned in the context of general measures intended to secure a reduction in the government or public sector deficit” (3)

In the UK, two objectives of privatisation are “reducing the PSBR” and “easing public sector debt repayments” (4)

"The Treasury is greatly interested in the revenue which can be obtained\(^1\) from the sale of public assets.

"Privatisation is .....viewed as a means of raising, in the short term or permanently, government revenues"\(^2\)

The above indicate the potential of privatisation for governments to raise revenue other than by taxation or borrowing. The PSBR is an important indicator for any monetarist government. The British government 1979 onwards is no exception. It is important to them that their annual PSBR targets are met and in the long run that the PSBR is reduced.

By selling off assets the government gains a short term boost to revenue. "The short term impact on the PSBR has several components. The PSBR is reduced by the extent of sales proceeds, the capital expenditure program of the company being privatised, and the company's payments of interest and dividends."\(^3\)

In Britain, for example, sales from 1979 to 1985 raised at least 6 billion pounds \(^4\). This diverted the need to raise funds through gilt sales, to print money or increase taxes.

Wiltshire believes the government had wider financial objectives-stated or otherwise.

---

"Although...the government has admitted that one of its objectives is to reduce government borrowing, virtually all analysts are agreed that this has a higher priority than is admitted. There is, however, a difference of opinion as to what the government's motivations are here. Some say it is simply to placate the City, which objects to being crowded on the money market. Some say it is to produce a fall in interest rates and the inflation rate. Some say it is to reduce the debt repayment on the budget, and others that, combined with the availability of revenue, it is used for political purposes." (1)

Using the revenue for political purposes ties in with the Yarrow comment that decisions are taken with a view to maximising electoral success. Perhaps government wished to reduce taxation for its supporters or reward them with profits from share dealings, but these would not be stated policy.

Financial objectives may conflict with other objectives. Revenue raised is short term and opponents of privatisation regard the process as short-sighted. The government foregoes revenue of any future profit a privatised enterprise would make. A typical reply to this argument is that privatisation reduces government responsibilities which should reduce the tax burden, and a reduction in the PSBR should increase private investment which had previously been crowded out by government borrowing. Nor would government need to subsidise loss making enterprises, but Kay and Thompson see another potential conflict between financial and other objectives:

"......monopolies are worth more than competitive industries. A Treasury concerned to maximise the revenue obtained from the sale of public assets

could not therefore be expected to support liberalisation” (1) and maximising the number of shareholders may mean underpricing shares and therefore accepting a lower return to the Treasury.

C Socio-political Objectives

Another objective with regard to the distribution of wealth “is the promotion of popular capitalism through wider share ownership” (2)

For example “In France, the number of individual shareholders ...increased fourfold since the privatisation program commenced and there has been a substantial mobilization of savings for investment in the stock market.” (3)

Similarly the UK privatisation programme caught the imagination of the British public, “eight to nine million were shareholders in privatised enterprises in 1987” (4)

The returns for UK investors have also been good.

“The average return over the twelve year period was approximately 19%. ..... This represented a significant return for the small investor compared to holding a building society account” (5)

Theoretically, this would deter shareholders voting for a future government which favoured re-nationalisation, would give more people a stake in the

---

economic welfare of the country and widen the distribution of wealth throughout society. Politicians of a different ilk might argue that you cannot sell to the public that which rightfully belongs to them and is merely in the care of the government, that privatisation simply puts into the hands of a minority that which belonged to everyone.

However, it is a stated major objective of the UK government’s privatisation programme among employees and public “to extend the ownership of wealth more widely in the economy, giving people a direct stake in the success of British industry and removing the old distinction between owners and workers” (1) This policy has had such a strong socio-political effect that the British Labour Party no longer aspires to large scale public ownership because it is seen as a major vote loser in the 1990’s.

On the other hand, it can be argued that when an enterprise has a particular social or other non-commercial objective, efficiency is necessarily sacrificed and losses are often incurred.

“If these objectives are sufficiently compelling it should be possible to accommodate them—especially those which involve subsidies—as part of privatisation and pro-competition strategies. For example, the government could contract the private sector to deliver essential services, keep prices below costs, and provide employment. Private sector suppliers could bid for a government subsidy, in return for which they could guarantee that the above requirements are met” (2)

Public ownership will continue to be used for certain social objectives especially as it is often difficult to do a rigorous cost-benefit analysis in an area where the importance of objectives may be hotly disputed.

D Clarifying the industry-government relationship

One of the paradoxes of privatisation is that governments which might have thought a lack of control would result from privatisation have found that there can, in fact, be more control in the most important areas after privatisation. Privatisation in the UK clarified the government-industry relationship.

"Michael Beasley, .... expressed the opinion that one of its main objectives and, from his point of view, its major advantage was that, for the first time, it had formalised the government's expectations of industry and contracted the government's role in the process... The deal between government and industry had to be made explicit, thereby removing the old pattern of chairmen of statutory bodies arguing that the government had never laid down clear objectives. The new contract so established had fewer rules and terms, especially regarding price control and commercial behaviour, with no back door methods of control such as deals with unions. The monitoring procedure itself is enshrined in this contract.” (1)

E Unstated Objectives

Wiltshire suggests that there are unstated objectives in the British privatisation programme. Vickers and Yarrow suggest that politicians are always conscious

of re-election prospects. Extrapolating from this, it may be concluded that governments world-wide might have important but unstated objectives.

“There is widespread agreement among analysts of privatisation that one of its key unstated objectives was to reduce trade union power in Britain”\(^1\) and according to Kay and Thompson “Although rarely articulated, privatisation may also be seen by the government as a means of disciplining the power of public sector unions”\(^2\)

Governments may wish to have unpopular decisions, redundancy for example, taken by the private sector whereas they may be politically unacceptable in the public sector. At the same time, they may wish to buy support by financially rewarding their supporters (possibly through capital gains from privatisation shares, or by tax cuts financed by privatisation revenues).

However, objectives vary from country to country and from one time period to another but “interest in privatisation is clearly worldwide. In many countries a principal motive behind actual and planned privatisation is to reduce the government resources flowing into the enterprise sector (Spain, Senegal, Niger); a need for additional revenue to secure a reduction in budget deficits is also apparent (Canada, Netherlands); improving efficiency through promotion of the private sector is often mentioned (Malaysia, Sri Lanka); and in some cases the objective is to revitalise failing enterprises that have been taken over by the government (Bangladesh, Chile, Philippines)” but in other

---

countries there may be relatively large programmes but little progress because of a "gap between ideological rhetoric and the real intention to act". (1)

**Methods of Privatisation**

Implicit in the discussion of methods of privatisation is whether or not free market forces are operating in a given country. Privatisation involves the transfer of both ownership and control of enterprises and activities from the public to the private sector.

"While one can accept the principle that the goal of privatisation is the promotion of free market forces, one may not accept, in all cases, that the first best policy to achieve this objective is the sale of public assets" (2)

This point and the effects of different methods on government revenue are discussed in greater detail (on a general level and with specific reference to Saudi Arabia) in Chapter 8.

Pirie describes twenty different techniques in "Privatisation: Theory, Practice and Choice", however, Andic narrows these down to four broader categories which are set out below. (3) These procedures take place after the government has prepared the enterprise or activity for privatisation in terms of legislation, regulation, promotion (i.e. business plans, prospectuses), consensus, discussion etc.

---

1. Divestiture

Divestiture can include the outright or partial sale of state holdings to private sector interests or the liquidation of the assets of some public enterprise. The pure sale of share interests in the type of activity normally is defined as privatisation in the sense that what was formerly public now becomes part of the private sector portfolio. Liquidation is also privatisation, for although in the process of liquidation no new private entity results, the assets themselves become part of the stock of private assets.

Partial divestiture may respond to a very different philosophy and to very different objectives. Why does a government sell off some shares in public enterprises but not all? Frequently, small sell-offs to multiple shareholders respond to a desire to promote capitalist value in the “little man” - very often the trade union or cooperative sectors. On the other hand a small sell-off to a single shareholder might have a very different motivation, such as bringing in an important client or supplier or creating profit-oriented pressures within the board of directors.

In the first case (bringing clients and suppliers) private sector participation could simply ensure greater control over the whole production chain, and may actually reduce the free play of market forces. By such a process, the public enterprise would firm up its implicit contracts and amplify its vertical integration. In the second case (bringing profit-oriented pressures into the boardroom) market forces are strengthened, at least as long as peace is maintained among the partners.
Likewise, asset liquidation may have different effects on the workings of the national market, depending on the particular situation at hand. Logically, the State would sell off a hopelessly unprofitable enterprise. The product would be produced and sold at market values and supplied according to how much the consumer wants to buy. Resource allocation is improved, and the taxpayers probably get a break. A second scenario might yield a different result, however, depending on the market structure of the product. Assume, for instance, that the State liquidates its interest in the market to a sole private supplier who can now proceed as he likes. Such a possibility should not be set aside as the exception that proves the rule. In many modernising countries, particularly with small local markets and imperfect competition, it is common for an industry to be dominated by a duopoly or an oligopoly in which the State plays a leading role in price setting and market division.

2. Contracting Out

Contracting out or the granting of operating concessions may be considered to be one of the more feasible techniques for privatising an economy. Here, the State retains its authority over a sector or industry, and may retain ownership of capital assets, but the contractual relationship with a private operator injects into the relation elements of profit maximizing and cost minimizing, at least when the government seeks these goals. This option is even more feasible when private companies prefer to act as contractors or concessioners. They avoid certain risks, may make no capital investments, and can nevertheless profit from their expertise if the contract itself gives premiums of this type.
Some multinational corporations have discovered the advantages of contracting long ago particularly in developing countries. For example, the Holiday Inn and Hilton international hotel chains do not own hotels; they merely run them, standardise them, advise on their design and construction, and incorporate them into their world-wide reservation systems. Other companies, whose comparative advantage is technological know-how, have favoured technical assistance contracts over direct investment, because the contract enables them to profit from their knowledge without suffering much capital risk in the process.

Governments increasingly favour contracting out for different reasons. The riskiness of asset ownership is hardly a consideration for them, due to their wide diversification. On the other hand, since the private sector has a comparative advantage in managerial skills and perhaps in technological knowledge, government can reduce the costs typical of its own management difficulties. Contracts also have the virtue of being renegotiable, which reduces the costs of errors in decision making. Furthermore, legal restrictions may require government direction in a given sector, such as health, education or public utilities.

3. **Attrition**

The least noticeable form of privatisation is one in which the government simply changes its way of initiating new projects and allows the private sector to invest in areas that were formerly exclusive to the State. By a process of attrition over time, the State is expected to control fewer and fewer transactions.
This type of privatisation should be expected to occur naturally in countries undergoing industrialisation, because the very process of economic development should create new private actors capable of engaging in activities in which in an earlier stage they could not. For example, the Emirate of Abu Dhabi is to privatise parts of its non-oil sector in 1995. This includes two cement plants, a flour mill, two mineral and a bag factory— all of which are profitable. (1) Privatisation by this sort of attrition depends largely on the lobbying skills of the private sector.

4. Competition

The above discussion makes it clear that promoting competition is at the heart of the privatisation debate. Those who resist privatisation in general do not question its objective - creating free markets and efficient production - but question whether divestiture of public enterprises is the only way of attaining the objective. In some cases the goal may be to improve management of public enterprises or to increase the competitiveness of the markets in which they operate. Thus, if privatisation policy is to be judged by the direction of such policy, it seems reasonable to examine this sort of shift.

Special Circumstances of ex-Centrally Planned Economies

The preceding discussion assumes that privatisation takes place in a mixed economy. Privatisation is a matter of redefining the parameters of the public and private sectors. Ex-Centrally planned economies present a special situation. There is a need to establish rules, institutions, property laws, accounting and bankruptcy rules, tax codes, labour laws, bank and financial market

1 - Arab News, Riyadh, April 5, 1995
supervision, that is the whole legal - institutional framework before, or at least at the same time as, privatisation. Consequently, rapid privatisation is exceptional in such circumstances. (1)

**Calculation of the Benefits of Privatisation**

This section describes the principle tools for assessing the benefits of privatisation. Hemming and Mansoor argue that: "privatisation should be assessed on its effect on economic efficiency." (2) Andic (3) does offer some guidance as to what should be looked for, in general, in an assessment and evaluation of privatisation in any country. He undertakes both micro-economic and macro-economic approaches as follow.

**A Micro-economic Approach**

1) **Criterion for profitability**

It must be determined whether or not post privatisation net value added is larger, or at least equal to, net value added by an enterprise before privatisation. Net value added is the value of outputs minus the value of current material inputs and services purchased from outside the enterprise minus investment outlays (i.e. depreciation in a normal year).

However, "perhaps the major limitation of ..... comparisons arises from the fact that public enterprises are assigned multiple objectives - including social obligations to deliver essential services, sell at below cost (which may involve

---

cross subsidisation), and provide employment - and to the extent these objectives must be traded off against commercial objectives, public enterprises are bound to appear less efficient in terms of the criteria by which private enterprises are judged.” (1)

So when assessing changes in profitability, it may appear that an enterprise has become more profitable in a purely accounting sense, but when the social implications are considered (and which in fairness Andic suggests are necessary), then pre and post privatisation profitability may not be so clear. Indeed, Wiltshire goes as far as to say that “virtually all the privatised concerns show healthy growth in profitability, but it must be remembered that the vast majority had significant ‘dressing-up’ before sale, including capital injection to reduce debt ratios, or re-arrangement of the pension schemes and the like. Consequently, it would be expected that they would record profitability results superior to those of the pre-privatisation period.” (2)

From a theoretical standpoint, a public enterprise in a non-competitive market (e.g. a monopoly) has the potential to be more profitable (as shown in Diagram -2, Monopoly Profit) than the same enterprise which is privatised and subject to competition. If a public monopoly simply becomes a private monopoly, then there is potential for increased profitability if it no longer has non-profit maximising objectives.

A profit maximising monopoly would maximise profit at output Q and price x leading to monopoly profit equal to area wxyz, whereas under perfect competition profit would be normal \((P = MC = MR = ATC\), as in Diagram -2 -.

ii) **Criterion of Efficiency**

There are several possible alternative ways to judge efficiency. One of the alternatives offered by Andic states "that the internal rate of return should be larger than it was prior to privatisation. In addition, the IRRp must exceed a
competitive market. In a freely competitive market (as illustrated in Diagram - .3), the enterprise produces quantity Q at price P. This has productive efficiency because it is at the lowest point on the ATC curve. Governments promoting privatisation efficiency are looking for such a position. If there is scope for such a gain, then it would be in line with Andie’s criterion.

**Diagram - 3 -
The Efficiency of Competitive Equilibrium**

From the standpoint of allocative efficiency, the above situation is the most efficient as it is a situation where cost equals benefit. Because marginal cost equals price, this is consistent with Pareto optimality. If the MC curve is taken as the enterprise’s supply curve and marginal cost is taken to represent the cost to society of various units of production, and the demand curve represents the value to individuals/society expressed through the price mechanism, since
minimum acceptable level which can be taken to equal the interest paid on foreign loans.” (1)

\[
\frac{\text{IRR}_p}{\text{IRR}_g} \geq 1
\]

Where \(\text{IRR}_p\) = post privatisation internal rate of return
\(\text{IRR}_g\) = pre privatisation internal rate of return

However, with reference to the UK privatisation programme “interpretation of the financial indicators ...... is a far from easy exercise” (2) because of different objectives and policies, and “that there are few examples of truly comparable public and private sector activities and enterprises” (3) but at the same time “public sector rates of return have been substantially below their private sector counterpart” (4) “ .... low rates of return and financial deficits ...... can, in a large part, be attributed to some combination of overinvestment and internal inefficiency, phenomena which have resulted from deficiencies in the overall framework of control.” (5)

This at least, suggests that post privatisation enterprises have scope for efficiency gains following a more market oriented approach by a management which is more accountable but also has greater control over the aims and policies of the enterprise.

From a theoretical standpoint, efficiency gains are possible if privatisation is accompanied by competition and the public enterprise was not part of a

---

society only pays the price which it values the production at, there is perfect allocative efficiency.

However, privatisation may not be accompanied by competition, and the social costs/benefits of the privatised enterprise may be ignored. Moreover, in large enterprises there may be scale economies which could be lost through competition. This point is discussed further in chapter eight.

**A Macro-economic Approach**

**Effects on Growth and Value Added**

Andic, in "*Privatisation Theory and Practice*", suggests that it should be determined whether or not privatisation leads to an increase / decrease in total value added as well as a change in the rate of growth after privatisation. Net value added is seen as:

$$ \Delta NVA = \Delta NVAd + \Delta NVAi $$

The net value added (NVA) is seen as

- Output - (Material Inputs plus Depreciation) and
- $d =$ direct effect of privatisation
- $i =$ indirect effect of privatisation including income multiplier effect on the sector where the privatised enterprise operates.

From this Andic calculates a rate of growth by comparing: $\frac{\Delta NVA}{\Delta NDP}$ where NDP = Aggregate net domestic product for the base year. ($^1$)

---

Some critics reported that privatisation resulted in a "loss of manufacturing opportunities in Britain" (1). Pomeroy comments that "that there are some parts of the world (I think in this category fall particularly lower-income developing countries), where the main management talent may reside in the public sector and not outside the public sector" (2).

If economic growth is taken generally as the increase in the economy's level of real output over time, or more specifically the annual percentage change of GNP per capita, then an evaluation of the effects of privatisation on growth must consider how the policy affects the determinants of growth.

If natural resources, human and physical capital, and the state of technology are taken as the building blocks of growth then, it is how effectively these factors are combined which will determine actual growth. Does privatisation lead to a more effective use of these factors or not? Does privatisation enable a country's production possibility to increase as more is able to be produced, (as illustrated in Diagram - 4 -

Initially, in developing countries, the public sector may be the only sector with the financial and managerial capability to exploit a country’s natural resources (e.g. minerals) and contracting out to a foreign enterprise may be unacceptable for non-economic reasons - though in many developing countries it clearly is an acceptable option. However, in a more developed economy, such resources may be better exploited by the private sector driven by the profit motive and possessing more business oriented management skills.

Again, in the developing world, the country’s capital stock may depend largely on government investment but at a later stage, because of the many demands on government finances, greater capital investment may be available through the private sector.

Even the technological capability of a country depends to a large extent on the government. Although the private sector may have the drive and motive
(survival, profit, and dominance in the market) for innovation, it is the government which sets the framework. The way government uses privatisation, therefore, is of vital importance.

Government is always involved in education, training, research and development. Will privatisation proceeds fund increased government spending in these areas? Will the private sector match or surpass government research and development in the ex-public sector? Will the government use privatisation proceeds to build up the country's infrastructure and give incentives for investment? Will the government follow policies which encourage savings leading to investment for growth, or will it simply go for current consumption and imports? In some ways, these are imponderables, but it suggests that privatisation is a potential weapon in the search for growth, but also that the outcome depends on how privatisation is used. It depends on the initiative of both the government and the private sector.

**Employment and Wages**

Does privatisation lead to a higher level of employment than before? To assess this we must consider direct and indirect effects.

"One of the effects of privatisation in the UK has been the large amount of unemployment created". (1) If trades unions are weakened, a drive for increased efficiency can mean a fall in demand for the input labour (possibly substituted by capital/contracting out on privatisation).

---

On the other hand, there could be an increase in demand for labour in the private sector if a release from the control of bureaucrats leads to new sources of finance, better management, investment and efficiency which give more competitive products which are more in demand (as illustrated in Diagram - 5). This assumes that there is excess capacity in the labour market.

**Diagram - .5 -**

**Increased Demand for Labour**

Wage Rate

Post production increase in demand for labour caused by increased demand for products/services

Q of labour

This release from government control could also have another negative effect - management could substitute cheaper/better quality imports for domestic inputs, and as the demand for labour is a derived demand, the demand for domestic labour would fall (as shown in Diagram - 6).
Diagram - 6 -

Fall in Demand for Labour

Post production decrease in demand caused by factor substitution, decrease in demand for products/services, decline in trades union power, increased efficiency, contracting out.

The flow of privatisation funds to the treasury may give a fall in interest rates if the PSBR is reduced. This may stimulate the private sector to invest and consumers to spend, which could further increase the demand for labour.

Indirectly, there could be an effect on the whole economy through the multiplier effect as changed demand for labour in one sector leads to changed spending and demand in other sectors.

Privatisation may have an effect on real wages (and salaries), through the free market forces of supply and demand. The effect may not be uniform throughout the different sectors. For example, in a particular sector there may be an increase in demand for labour but supply is inelastic, causing an increase in the wage rate.

However, in a sector where supply is perfectly elastic, an increase in demand for labour has no effect on the wage rate.
In a situation where the demand for labour falls, the outcome will depend on the elasticity of supply. If supply is elastic, then a decrease in demand can be expected to bring about a fall in the wage rate.

In the UK, there have been post-privatisation "substantial fee increases, usually at least threefold, for directors of enterprises once they have been privatised"(1) which was also accompanied by a rise in management salaries(2) which has not been matched by the rest of the labour force.

**Balance of Payments**

An assessment of the effect of privatisation on the Balance of Payments can be estimated by looking at the following areas where (+) is a favourable repercussion and (-) is a negative implication.

- (+) reduction in imports (-) increased imports because of growth
- (+) output exported (-) increased imports because imported inputs
- (+) public foreign debt reduction (-) public foreign debt increase

In theory, privatisation could have no effect, a negative effect or a positive effect on the Balance of Payments.

If we assume that a privatised enterprise becomes more efficient, market responsive and price competitive, it could be that its products are more attractive abroad if it is an exporter. Then, OTRE, an increase in exports could be expected. Conversely, if the enterprise becomes less efficient, less market

---

responsive and less price competitive (possibly through loss of subsidies), then a fall in exports may occur.

In the domestic market, it may depend on the market type. If a public monopoly becomes a private monopoly, then there is little to suggest that privatisation would encourage imports to replace the final product. However, if a public enterprise is exposed to foreign competition, then there is the possibility of increased imports as consumers substitute imports for domestic products.

In Britain, privatisation caused a "rising level of imported goods .... as a result of freeing the nationalised industries from tight government control."

Regardless of market type, a privatised enterprise free from government restriction could import inputs (e.g. raw materials, capital equipment) which it sees as cheaper/more appropriate.

Again, if privatisation leads to growth in the economy as a whole, increased imports, depending on the Marginal Propensity to Import, can be assumed, and vice versa.

As far as financial flows are concerned, the situation is complex. Privatisation should lead, in the long run, to a reduction in the foreign debts of public corporations. Initially, capital could flow into the country if privatisation shares are available to foreigners. Foreign companies may be more inclined to set up production in a market which is seen to be expanding and liberal (or not if government incentives are cut), but later, there could be the adverse effect of profits and dividends being re-patriated and privatised enterprises investing abroad. Interest rates reduction (after privatisation funds flowing to the treasury

and PSBR reduction) could see "hot money" flowing out, but at the same time foreign industrial investment flowing in.

In their conclusion on the effects of privatisation on the balance of payments, Hemming and Mansoor state privatisation "of itself cannot affect the current account of the balance of payments ....... But if privatisation raises the overall productivity of the economy, net exports should increase." (1)

**Impact on the budget**

Does privatisation give the government the advantage of increased tax revenues, reduction in subsidies and debt servicing compared to pre-privatisation?

Theoretically, privatisation itself may have no effect at all on the budget, may have an adverse effect or it may have a beneficial effect if the policy promoted economic growth. There is, however only an indirect correlation between the budget and privatisation.

Other things remaining equal, assuming a privatisation programme leading to increased growth and income in the economy, this should lead to increased tax revenues. Subsidies to the privatised sector would cease and funds flowing to the treasury could reduce the PSBR and debt repayments. Supporters of privatisation would argue that privatisation will increase investment and employment, and unprofitable enterprises will become profitable so the above beneficial scenario is not unrealistic for the government. Indeed privatisation

---

“allowed the UK government to repay about £25 billion of fixed interest of bond repayment.”

On the other hand, it is possible that the government then has to fund more unemployment - at least in the short run - as labour is shed in a drive for efficiency. In the short run, there is an inflow of funds to the treasury of privatisation funds but this is at the expense of the long term income stream from any profitable public enterprise. Again, it can be argued that the whole privatisation process, if done wisely, will generate growth and greater future revenues. It is also quite possible that a government could use privatisation revenue for its own ends - to cut taxes, for example, to reward its supporters. Factors outside its control could reduce demand and employment (e.g. world recession) and, therefore, reduce tax revenues. The government, in such a case, may in fact increase its borrowing and spending to combat deflation, unemployment and potential political unpopularity.

**Impact on Saving and Consumption**

Does privatisation lead to a change in savings and consumption or not?

Perhaps more meaningful is to consider the effect on the marginal propensities to consume or save. The effects of privatisation may not be evenly spread throughout the different sectors of the economy. For example, any increase in income for the poor may be totally consumed but for the rich may be totally saved. Clearly, there is some potential for privatisation to have effects on the MPC/MPS.

---

Positive Effects of Privatisation

Privatisation may also have non-income specific effects on consumption (positive or negative).

Let us assume, for the sake of argument, that the effects of privatisation are positive. People, in general feel wealthier, their expectations for the future are good, interest rates fall because of a reduction in the PSBR, and there is a redistribution of wealth from rich to poor (practically all income transferred to the poor is assumed to be spent on consumption).

People benefit from increased income. Consumption and savings both increase. Whether increased income and consumption will mean inflation or balance of payments problems and whether increased savings mean increased investment and future growth will depend largely on individual economies.

The Andic approach depends on the quality of the data which can be gathered, (which may be problematic for developing countries) and calculations are only as good as the assumption underlying them. The effects of privatisation may still be too new in many countries to make objective judgements.

BARRIERS TO PRIVATISATION:

Usually, there are typical constraints to implementing privatisation programmes smoothly, among which is employee opposition, which is often translated into political decisions not to privatise. Public sector employees usually tend to fear that privatisation will mean either the loss of their jobs altogether or at least a reduction in pay and fringe benefits. While either of
these consequences may occur, a number of techniques are usually developed as part of the sale package to secure the rights and the positions of staff.

Secondly, there may be a lack of an adequate financial market, which is a critical tool for achieving private ownership and mobilizing savings. Without the earlier revitalization of the financial market infrastructure brought about by policies encouraging the growth of the Eurobond markets in London, for instance, the massive domestic and foreign distribution of privatised company shares in 1980 would not have been possible.

In developing countries, there is also a lack of adequate public information to help to sell privatisation to both the public and private sector’s investors. This is also undermined by the fact that the number of trained specialists to execute privatisation programmes is very limited. In many cases neither the private sector of the economy nor the capital market is sufficiently developed to yield even an approximate valuation. And even where a market value can be established, the thinness of domestic capital markets necessarily places limits on the ability to finance privatisation from domestic resources.

Despite widespread interest, however, the obstacles are real and formidable. In some countries, especially centralised economies, the legal basis for private ownership is unclear or embryonic, the domestic population's resources are illiquid, stock markets are virtually non-existent, and the banking and credit system is in desperate shape.
Examples of International Experiences

Privatisation has now been pursued in different countries with a variety of promising benefits. Most of the objectives in both developing or developed countries were economic. This makes "privatisation" a natural response for the world's economic recession.

The style for either introducing or enforcing privatisation is different from one country to another as they differ by circumstances, skills and experience. In the following discussion, four examples will be given:

The first is the privatisation programme in Britain. This is the pioneer and bench mark example of privatisation in the whole world. Privatisation has been introduced in the UK faster and in more controversial areas than anywhere else. This programme benefited from full government support, well organised marketing strategy, and well established financial institutions.

The second example is privatisation in Malaysia. This example has been chosen for two reasons. The first is that the Malaysian economy is prosperous like the economy of Saudi Arabia and the similarity between the two can be established. Secondly, it illustrates a considerable degree of planning in the design of the programme. This may provide a valuable lesson of experience that might be followed.

The third example is privatisation in Jordan where the economy is based on private market initiative and activities. The experience there illustrates the potential role for an ambitious privatisation programme in freeing the country from a continued reliance on the Gulf States' support.
The fourth example is privatisation in Egypt, as this is privatisation encouraged by external forces rather than emerging as a result of local plans.

The variations among these four examples in motives and objectives illustrate vividly the importance attached to the locality and context of privatisation in the design of plans or evaluation, or even when considering privatisation as an instrument for change and growth.

**PRIVATISATION IN BRITAIN**

The year 1979 sign-posted the real beginning of the privatisation programme in UK. What distinguishes the British experience ever since is that it provides a unique example of privatisation. It has been pushed further, faster, and into more controversial areas than anywhere else.

Objectives of the programme were clearly identified. They were both political and economic. These included generating more revenue, control of P.S.B.R., cutting taxes, financing election promises, reducing the size of public sector in financing services, and diminishing the power of trade unions. Clarity of the objectives was an essential and significant step towards the success of the programme.

The public sector in Britain in 1979 was the most significant aspect of the economy. Public corporations accounted for some 10 percent of the UK's output. This percentage was reduced to 5.5 percent in 1988 as a result of the active privatisation programme. That involved privatising twenty-five public
enterprises during the Conservatives' first term in office (1979-83) which raised £14,400 million through the sale of public assets. (1)

By the beginning of 1987, twelve major companies and a large number of small ones had been privatised, 20 percent of the state sector and over 400,000 jobs had transferred to the private sector. The contribution of this development is further significant in raising revenues amounting to £12 billion. In addition, over three-quarters of a million council houses had been sold, raising £8 billion for the government.

The expansion in the scale of the programme accelerated resulting in annual proceeds from asset sales of about £5 billion annually as the following table shows:

Table - 4.1

<table>
<thead>
<tr>
<th>U.K. SALE PROCEEDS FROM PRIVATISATION (1979 - 1990)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Year</td>
</tr>
<tr>
<td>----------------</td>
</tr>
<tr>
<td>1979 - 1980</td>
</tr>
<tr>
<td>1980 - 1981</td>
</tr>
<tr>
<td>1981 - 1982</td>
</tr>
<tr>
<td>1982 - 1983</td>
</tr>
<tr>
<td>1983 - 1984</td>
</tr>
<tr>
<td>1984 - 1985</td>
</tr>
<tr>
<td>1985 - 1986</td>
</tr>
<tr>
<td>1986 - 1987</td>
</tr>
<tr>
<td>1987- 1988 to 1989 - 1990</td>
</tr>
</tbody>
</table>

Source: John Vickers & George Yarrow: Privatisation: An Economic Analysis, P-155.

1- Cento Veljanovski: Selling The State - Privatisation in Britain, Weidenfeld Paperbacks, 1988, p. 4
The figures in the table seem to indicate only that immediate funds became more available to the British government as a result of the sale. Such funds might have contributed to the reduction of the level of the P.S.B.R as a short term answer to the budget deficit. However, privatisation should not be used primarily to solve problems of government finance.

"Privatisation is no substitute for reducing public expenditure, or for increasing tax revenues or for reducing the monetary expansion of the central bank. I emphasise this point largely because many people appear to believe that privatisation is a way of reducing public spending." (1)

Revenues from sales must be re-invested for future growth - not simply used to finance unemployment benefits, tax cuts or an over-valued currency. However, the British experience is regarded as the main bench mark for modern privatisation programmes in the world. It is very unique in the sense that it was undertaken on a very large scale with full governmental commitment compared with any other country. This experience was characterised by the following:

- The influence of city financial institutions on the government's privatisation programme.

- Privatisation programme in UK had a wide variety of objectives, some were announced, others were not, but they were clearly identified. These included reduction of PSBR, restricting trade-union powers, financing

---

election promises, dealing with the failure of some of the nationalised industries.

- UK privatisation emphasised the importance attached to "Marketing Techniques" in the sale of the enterprises, for instance: small investors were involved through preferential allotments, loyalty bonus shares, and gradual payments towards the share price; different kinds of pricing and selling channels have been adopted; consultation with merchants banks was established; and promotion of sale through media publicity was carefully planned and executed.\(^{(1)}\)

It has increased by three quarters the number of individuals owning shares, thus contributing to the government's goal of creating a property-owning democracy.

Privatisation in the social sectors, e.g. health, education was limited and restricted mainly to contracting out some services in those sectors. However, in recent years management of resources in both the health and education service has been transferred.

Economic advantages of privatisation programmes are felt through the reduction of the level of P.S.B.R. without cutting public expenditures or raising taxes. Also in the increased revenues from the sale of public assets as well as the possible increased share of the sector in the formation of GNP

\(^1\) - V.V Ramanadham (editor): Privatisation in Developing Countries, Routledge, London, 1989, p. 29
"The accumulated experience of privatisation in Britain has taught an important lesson: there is no part of the public sector which cannot be helped by privatisation. Private sector businesses have been brought into the state health service to do cleaning and catering in hospitals; they have entered the state educational system to clean schools and prepare school meals. They have been used in military bases and to perform police services. Provisions of earnings-related benefits is dominated by private firms. The nation's telephones and gas supply have been turned into private and profitable activities. The building of ships and the ports they dock in are private. The North Sea Oil business, electronics and aerospace are all private. The trucking firms, the bus lines and the ferry operators are private. Leyland Bus and Jaguar cars are private. The state airline and the state airports have left the state sectors". (1)

Sir Geoffrey Howe also outlined the benefit of the British privatisation programme as follows:

First, privatization has relieved the state of what was the huge and growing burden of financing the investment needs and operating deficits of the public corporations. In 1979 the nationalised industries were costing British tax payers over £50 million as week. Second, privatisation has raised substantial proceeds which have helped finance tax cuts, priority public spending, and a reduction in budget deficits. Third, privatisation has massively expanded personal share ownership. By the end of 1990 the number of shareholders reached 9 million - 13% of British adults. Fourth, privatisation has generally

improved the internal efficiency of formerly state-owned firms and has allowed increased investment in such firms. Fifth, where privatisation of former monopolies has been accompanied by liberalization, as in telecoms, it has increased choice, reduced prices and greatly empowered the consumer.\(^1\)

The British experience was criticised on the basis of the likelihood of increased unemployment, on the basis of the threat it presents to the role of trade-unions, and on the negative impact it introduces to services with social objectives such as the N.H.S. that might become commercial and discriminatory.\(^2\)

**PRIVATISATION IN DEVELOPING COUNTRIES:**

There is special importance attached to privatisation programmes in developing countries, given their functional capacity to influence structural change strategies including the transition to a market-oriented economy.

Structural changes and adjustment strategies involve: reduction of the size of the public sector as can be seen in the British experience. It could also involve increasing the role of the private sector while reducing the reliance on one economic activity. As can be seen in Saudi Arabia, this could increase the share of the private sector in the formation of GNP while reducing the dependence on oil.

Such a strategy would require: major trade liberalisation, decontrolling prices, reducing the fiscal deficit by closing the special access of public enterprises to

---

the treasury or central bank to cover operating losses, and reducing the public subsidies.

The new structural adjustment and privatisation programmes in developed and developing economies indicate that:

1. A significant departure from the early post-war period's widespread belief that private initiative in developing countries would not be sufficient to develop the required industrial and agricultural base or foster an efficient allocation of financial resources.

2. The private entrepreneurial class is growing with focused attention on production and competition.

It is worth noting that this change of policy is a direct consequence of the failure of the state intervention scenario especially in countries with socialist, centrally planned economies like the Soviet Union, China and Eastern Europe.

Their scheme of planning assumed that public enterprises would operate in a framework of market accountability, management autonomy and incentive for efficiency. Therefore, most of the manufacturing sector was passed into the hands of the government as well as services, mining, banking, foreign trade, construction etc. The outcome was that the private sector was reduced to a subsidiary role, and their central planning displaced the market system as the driving force in the allocation of resources.

The costs of this large-scale public sector involvement were greater than in developed countries, and social objectives were not satisfactorily met. It was impractical for their governments to manage efficiently all their investment in
enterprises without the adequate support of the producing sector and market discipline. Recent movements back towards socialism in Hungary and Poland, for example, do not negate the above. It only demonstrates that privatisation market forces have to be introduced in a carefully planned way and not overnight or there could be public disillusionment.

PRIVATISATION IN MALAYSIA:

The decision to pursue privatisation in Malaysia was influenced mainly by economic hardship and over expansion of the public sector. The government presence in various areas of the economy had become pervasive. Government was not only involved in providing basic services and infrastructure, it had also become involved in activities normally within the purview of the private sector e.g. manufacturing, banking, steel industry, etc.

Statistics from the Central Collection Unit (CICU) of the National Equity Corporation (PNP) indicate that, as at December 1986, there were 736 public enterprises in Malaysia of which 380 were federal and 356 were state owned. Table (4.2) indicates the concentration of government activities in agriculture, manufacturing, commerce and trading and construction.

This large government involvement in public enterprise made the value of investments, in 1987, for example, amounting to M$ 5.739 billion reach M$29 billion in 1990.
Table - 4.2
BREAKDOWN OF PUBLIC ENTERPRISES BY SECTOR

<table>
<thead>
<tr>
<th>Sector</th>
<th>State</th>
<th>Federal</th>
<th>No</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Fishing, Forestry etc.</td>
<td>64</td>
<td>19</td>
<td>83</td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Mining</td>
<td>8</td>
<td>12</td>
<td>20</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>80</td>
<td>89</td>
<td>169</td>
<td>20</td>
<td>23</td>
</tr>
<tr>
<td>Transportation and Communication</td>
<td>10</td>
<td>38</td>
<td>48</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>Commerce and Trading</td>
<td>34</td>
<td>24</td>
<td>58</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Banking and Finance</td>
<td>8</td>
<td>38</td>
<td>46</td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Construction</td>
<td>62</td>
<td>43</td>
<td>105</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Other (Services)</td>
<td>90</td>
<td>117</td>
<td>207</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>356</td>
<td>380</td>
<td>736</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

Source: V. Ramanadham: Privatisation in Developing Countries, p. 126

The P.S.B.R. had consequently increased to satisfy such demand. The budget grew at a very fast rate. But on the other hand many companies were inefficient, due to lack of managerial skills and bureaucracy.

"The overall poor financial health of public enterprises in Malaysia is partly due to the government's policy of transferring the more successful and profitable PEs to the National Equity Corporation, with subsequent listing on the Kuala Lumpur Stock Exchange. This poor performance is also due to poor planning and management by the PEs themselves, further aggravated by the worldwide recession and drop of commodity prices". \(^{(1)}\)

Therefore the objectives of the privatisation programme in Malaysia were framed to:

1. Reduce the size of public sector.
2. Reduce the financial burden from the shoulder of the government and consequently the size of P.S.B.R.

\(^{(1)}\) - V. V. Ramanadham (editor): Privatisation in Developing Countries, Routledge, London, 1990, p. 220
3. Promote competition and efficiency.
4. Support the private sector.
5. Regulate economic activities.
6. Improve the responsiveness of public enterprises to the market.

The Malaysian government approached privatisation conscientiously and selectively. This was because it aimed to achieve a smooth transition to the newly growing private sector. In 1985 all ministries and agencies had been directed to examine their programmes and activities in order to identify in part or in whole the potential projects for privatisation.

The Malaysian cabinet has appointed an Economic Planning Unit (EPU) with assistance from the Implementation Coordination Unit (ICU), the Treasury, and the Public Services Department (PSD)-to coordinate the work involved in preparing proposals for privatisation.

In addition, a privatisation committee with overall responsibility to expedite the privatisation programme was established. Another technical group for support to all sectors was formed and guidelines for privatisation were issued. This covered policies, forms of privatisation, and the institutional frame of reference for privatisation. In this approach lies an obvious attempt to involve all sectors of the economy, all ministries, agencies and private sector institutions. The establishment of the technical committee and the issuing of guidelines demonstrate a committed support from the government to the programme and it shows a desire to learn from other experiences.

Privatisation in Malaysia took different forms. These include partial privatisations, contracting-out, management skill contract and leasing. For
example: the TV was partially privatised to industries, while the North-South Highways was contracted out to United Engineering. The container terminal at Port Klang was leased to the private sector while retaining public ownership, control and management. The Malaysian Airline System (MAS) and the National Shipping Line (MISC) were partially sold to private institutions and individuals.

In the health sector the government devised a system of allowing general practitioners and private doctors to serve about 4 hours per session for a stipulated period in the government hospitals. This system was introduced as a pilot project at the Kulim Hospital. This would enable the doctors to utilize the facilities of the government hospitals instead of setting up their own at great expense that they might not be able to afford.

The privatisation of Malaysian Airlines was carried out primarily to secure additional capital to help finance its expansion plans and fleet modernization.

"MAS needed some M$ 2 billion for its 5-year plans. Though a portion of the money could be raised form MAS's retained earnings and loans, it still needs about M$ 500 million. This amount will certainly drain a big portion of the government's resources particularly in the current economic slow-down."(1)

Thirty percent of MAS's equity (worth M$ 105 million shares) was offered for public subscription, of which M$ 52.5 million was for the general public, M$ 17.5 million for the Airline's employees and M$ 35 million for public institutions, including National Equity Corporation and Employees Provident Fund. However, the government retains full control over the board and

1 - V. V. Ramanadham (editor): Privatisation in Developing Countries, Routledge, London, 1990, p. 223
management of the Airline through the issue of one special-rights, redeemable preference share of M$1 known as the "golden share".

As a result of the privatisation programme MAS was able in the early 1990's to expand its services and modernize the fleet through a purchase of 72 aircraft costing a total of M$10.6 bn (US $ 4.16 bn).

The progress has encouraged the Malaysian government to sell another substantial tranche of shares (32 percent) in a deal worth M$1.79 bn (US $ 700 million). (1)

With less government control, it is hoped that MAS would become a leading international and regional carrier.

The privatisation of the shipping line was done in a similar fashion. It was privatised through public floatation of shares with the government holding or retaining a golden share.

The setting up of the third TV channel did not constitute a divestment, but to provide services on a competitive basis to those already being provided by the two government channels. With this privatisation, the government would be getting a royalty between 3-7 percent of the gross revenue of the station.

In September 1983 the operating license was given to the Fleet Group, with the Ministry of Information and the Ministry of Energy, Telecommunications and Posts both acting as overseers. The Fleet Group incorporated a subsidiary called Sistem Televisyen Malaysia Bernard (STMB) with an authorized capital of M$ 20 million and a paid-up capital of M$ 10 million.

---

The main shareholders of this company are Fleet Group (holding 40% of the share) Utusan Melayu (holding 20%). Syed Kechik Foundation (holding 20%) and Maika (holding 10%), the remainder 10% is held by other private individuals.

Other examples of privatisation in Malaysia include: overhaul, repair and maintenance of aircraft (AIROD) which is the earliest military establishment to be privatised. Also telecommunication services and the construction sector as well as other projects which are in the process or targeted for privatisation.

It is worth noting that the objectives and style of privatisation in Malaysia was largely influenced by the many chronic problems faced by this country.

The growth of this country depended on the public sector alone. To face such tremendous demand the government had to borrow to finance different sectors of the economy. Thus, privatisation in this context is a matter of necessity rather than organisation. Because most of the economy's operations were held in the hands of the public sector, a selective, conscious approach was adopted both in identification of potential projects and in the implementation of the policy in order to avoid any non-desirable political implications.

Privatisation policy and objectives were announced and technical support was provided including the use of private consultants as in the case of the telecommunication service. Due to the complexity of privatising this sector, the Arab Malaysian Merchant Bank was appointed as the adviser. The questions, thereafter, are: has privatisation worked? Did it achieve its objectives?
Privatisation in Malaysia had initial problems but it has been implemented successfully and according to plan. Expenditure on public sector personnel has been considerably reduced, while the sale of public sector companies and assets, the revenues from lease payments and corporation tax and the reduction in government exposure to loans and loan gurantee have all benifited the Exchequeur. In the words of the Minister for Energy, Telecommunications and Post in Malaysia:

“Privatisation has enhanced economic growth through more rapid expansion of the corporate sector, great efficiency in the implementation of the infrastructure development programme. It has also contributed to the expansion of the Kuala Lumpur Stock Exchange” (1)

However, the lesson of the Malaysian experience, albeit new and relatively limited, is very useful indeed. It shows that full governmental commitment is an indispensable element of any successful privatisation programme. It shows also that selectivity and smooth transition, especially with projects that have social implications, are very important.

The Malaysians have continually carried out assessments of the progress of their privatisation programme so that they build-up in success.

PRIVATISATION IN JORDAN

The economy of Jordan is basically market-oriented with limited public sector involvement especially in the productive sectors of the economy such as

agriculture or industry. The total value-added generated by the public sector averaged 21 percent of the gross domestic product over the past 18 years. This figure includes other services provided by the government such as defense, education, and health. This reflects the degree of private sector involvement and participation in business and development.

The whole business environment for privatisation is conveniently supported by active private sector involvement and well trained manpower.

Privatisation has also benefited from the fact that the number of Jordanians working in the Gulf countries alone is equivalent to more than half the number working in Jordan and their remittances exceed the foreign exchange earnings from total merchandised exports. In 1986, the government of Jordan announced officially its intention to pursue privatisation as a new development policy, especially in view of the economic recession which had led to a 20 percent drop in the private sector formation of the gross fixed capital during 1985-1987.

The first step was the establishment of a ministerial committee with responsibility to encourage the role of the private sector in the economy and evaluate privatisation proposals whether in the form of transferring control of public enterprises to the private sector or in the form of introducing private sector management techniques to public sector enterprises; including commercialisation of such enterprises.

The privatisation strategy consisted of two elements. First there was increasing autonomous private investment through deregulating the business environment in which the private sector operates. The second was in public
involvement in commercial activities through the actual sale of assets to private entrepreneurs.

The institutions targeted for privatisation were: the Royal Jordanian Airline, the Public Transport Corporation, and Telecommunications. The Royal Jordanian Airline was identified as a target for privatisation in an initial survey conducted in 1986. This followed a drop in revenues and profits in 1983. Telecommunication was the only profitable enterprise among the three but it was crippled by an inefficient civil service system and regulations.

The Jordanian experience is generally limited in years and coverage. However, although this case illustrates a favourable business environment, an extensive involvement of the private sector, and limited manpower problems, the constraints to privatisation in Jordan are complex.

Many public sector enterprises need reforms in order to make the privatisation scheme possible and to ensure that the expected increase in efficiency will eventually materialise.

Another problem facing a number of enterprises is the intervention of the central government in pricing their products. Although some price regulations are legitimate on the basis of defending social welfare and securing the interests of the public, other regulations are perceived to be detrimental to the efficient operation of the enterprise.
"The government, for example, required the Jordanian airline to give 25 percent discount to government employees and a 50 percent discount for ambassadors and retired army personnel and their family members"(1)

Other constraints include:
- weak system of financial and management control.
- weak system of incentives
- inadequate accounting system
- high inflation rates

The privatisation experience, in Jordan, illustrates also that the objectives for such programmes can be wide and diversified. Among the motives for these alternatives is to achieve economic independence or self-reliance by improving the functional capacity of the domestic economy and the role of the private sector.

The economic slow-down in Jordan was largely caused by the economic conditions in the oil exporting countries of the Gulf Cooperation Council (GCC) as a result of the sharp drop m oil prices. The GCC countries contribution to the Jordanian budget amounted to one half of the government domestic revenues in 1983. Therefore, there was special strategic importance attached to privatisation in Jordan. This programme, in such circumstances, is a matter of necessity, survival and self-reliance.

1 - V. V. Ramanadham (ed): Privatisation in Developing Countries, Routledge, London, 1990, p. 246
Privatisation in Egypt

Privatisation was introduced in Egypt as part of a comprehensive economic reform and stabilisation programme agreed with IMF in May 1991. The package of assistance provided by the international community - which is conditional on Egypt's adherence to commitments made to the IMF, includes a phased $300 million structural adjustment loan from the World Bank and $20 billion debt relief and rescheduling agreement reached with the Paris Club of seventeen creditor governments.(1) Thus the objectives of the privatisation programme in Egypt are:

a) Debt relief, which is a special aim in this case by comparison to other counties, e.g. Saudi Arabia and Britain which were aiming to reduce public sector borrowing requirements internally, and Malaysia or Jordan.

b) To reduce the dominance of the public sector over the Egyptian economy. Since 1960, with the nationalisation of Egypt's industry by President Nasser, the public sector has been the centre of almost all economic activity.

c) Diversification and encouragement of the private sector as the principal source of growth and development.

The attainment of these targets through privatisation will help Egypt to shift its centralised economy to a more market oriented economy.

---

Examination of these objectives shows that, here, privatisation is adopted only for economic purposes - especially the closing of the fiscal gap through debt relief.

"Progress toward debt reduction was achieved when, as a result of Egypt's participation in the coalition forces during the Gulf War, more than $10 billion owed to the Paris Club of western creditors was cancelled. Additional debt cancellations by Arab countries reduced Egypt's foreign debt from $49 billion to less than $29 billion."

In view of the complexity and intensive involvement of the government in all sectors of the economy, especially industry, the reform programme has been introduced gradually. This will help the government, as it is the major subsidiser and provider of services, to reduce the impact of the removal of subsidies or increase in prices on Egypt's 58 million people.

"The government was still reluctant to give autonomy to SOE's and let market forces establish prices for their goods and services, and continued to maintain a high level of tariff protection."  

Progress toward privatisation began by removal of some subsidies on essentials, like electricity and fuel. Subsidies, however, remain on such basic food stuffs as sugar and flour. The second step was trade liberalisation. Import restrictions have been reduced from three hundred categories down to seventy-two. The tariffs have been reduced by up to one hundred per cent and

accompanied by the removal of preferential treatment given to public sector importers. Prices have also been decontrolled, especially in the manufacturing and agricultural sectors.

Egypt has also carried out some legislative and administrative reforms in the public sector. The benefit of this step is mainly to improve the marketability of some of the SOEs. In 1991 the government introduced law 203 under which the majority of the three hundred and eighty SOEs were reorganised as subsidiaries of seventeen newly formed holding companies which took-over management from some of the ministries. Such a step separates ownership from management with the purpose of giving full autonomy to the holding companies and their affiliated companies.

Privatisation took different forms including contracting out the management of state-owned hotels to private sector contractors, including Sheraton, Marriott, Hilton and Oberoi. It also involved the sale of some other hotels, e.g. the Meridian in Cairo and the Sheraton at Al-Ghardaga, and more than two thousand enterprises all over the country.

Moreover, there are two important facts which need to be highlighted with respect to the Egyptian privatisation programme. The first is the labour issue, as the government is very sensitive about making any worker redundant in the process of privatisation. Any reduction of manpower has to come through voluntary agreement between workers and employers in order to avoid any adverse social implications. This seems an important step not only to maintain the image of the socialist welfare state that has been built over the years, but also to avoid the creation of any more pressure groups in this heavily
populated country. The second point is that the Egyptian economy has responded quickly and positively to the reform and privatisation programme in comparison to other developing countries. According to a report by the World Bank to the Egyptian president, the economy is responding well to the reform measures.

"GDP growth, the balance of payments position and the level of foreign exchange reserves have surpassed expectations. Egypt's balance of payments reached a surplus of $5.5 billion last year, after a negative $2.5 billion two years ago. At present, Egypt has between $9 billion and $10 billion foreign exchange reserves, whereas most countries implementing structural adjustment programmes have no reserves." (1)

Such progress may give the impression that privatisation has completely worked as a result of shifting towards private sector skills and capabilities. This is not necessarily true. The private sector in Egypt has had a long history of chronic problems including an unbalanced financial structure, the wrong choice of production technology, lack of managerial efficiency, but above all, a limited size of private saving. Consequently there has not been enough private capital to acquire public enterprises which have become candidates for privatisation. This problem was apparently at the forefront of the Egyptian privatisation plans, and has been overcome through the introduction of the

radical open-door policy - 'the Infitah' of the late President Sadat. This policy encouraged direct foreign investment as the substitute for the local private sector. This raises a major concern as privatisation should not, in the eyes of many, result in control of important enterprises by foreign capital.

**LESSONS FOR SAUDI ARABIA**

Although privatisation is a quite recent phenomenon, it has already acquired its orthodoxies and high priests. Even a casual examination of the results achieved from this process in most less developed countries indicate a more positive shift towards better management of resources, better re-structuring of the economy and greater efficiency.

Privatisation has emerged as a diverse phenomenon which almost invariably differs in some important respects from one country to another. To an even greater extent, diversity arises because not only the aims of privatisation but also the methods used to formulate and implement privatisation are closely conditioned by a country’s political, economic and social values and institutions.

Since every country is unique in some way, the results in one country usually differ markedly from those in another even when both have adopted the same privatisation methods.

Yet, every country has aims, problems and techniques which are common to all. It is, therefore, a mistake to believe that the privatisation experience of one country has no relevance to others - as much a mistake as it is to think
that one type of privatisation is the answer to development in all countries at all times.

It is fortunate that the earlier adoption of privatisation in many countries will make it possible for Saudi Arabia to study these experiences and draw important lessons that provide guidance for better formulation and implementation of a privatisation programme.

As far as Saudi Arabia is concerned other countries’ experiences can be divided into two categories - the process of privatisation and the consequences.

It is not known which method or methods of privatisation the Saudi government would favour. If it is to take the form of “contracting out” then other countries probably have little to offer as examples. Saudi Arabia already has a long and successful history of “contracting out”. On the other hand, if privatisation is to be a transfer of assets from the public to the private sector, there are important lessons to keep in mind.

The British example illustrates the importance of political commitment, consistency and clarity of objectives (even where objectives are not stated or change over time). Privatisation will not be universally popular so there needs to be the political will to carry the programme through. The Malaysian programme was accompanied by a continued process of evaluation to assess the success or failure of the programme. Saudi Arabia could adopt a similar approach and modify its approach accordingly.
All the previously mentioned countries had to go through the stages of evaluation, design and implementation and had to set up the necessary legal and regulatory framework for privatisation. Saudi Arabia would be no different and if the aim is to increase efficiency through competition, then watch-dog bodies such as in the UK may be set up.

"Extreme care is necessary in fixing the price at which a public enterprise is to be sold to private parties" (1) The British government was accused of selling assets off too cheaply in some cases. This illustrates the importance of finding the right price consistent with privatisation objectives. If the Saudi government wishes to raise as much revenue as possible to help reduce a budget deficit, then it would want as high a price as possible. However, this may be in conflict with other motives such as rewarding citizens by increasing their share of the nation's wealth or making the programme very attractive to investors. The British government used specialists to value privatisation assets and this is in the interests of both the government and investors. This is perhaps more important in Saudi Arabia. According to Henry T. Azzam, standards of accounting and disclosure for Gulf companies need to raised to international levels. (2)

Unlike Britain and Malaysia, Saudi Arabia has only a fledgling stock market with dealings done through the commercial banks. If widespread share ownership and dealing is aimed for, then there is the task of setting up the financial market to cope. This would involve an extension of regulation and legislation especially if non GCC nationals are to be allowed to participate.

---

1 - V. Ramanadham (ed): Privatisation in Developing Countries, Routledge, 1990, p. 26
2 - Henry T Azzam: Arab News, April 11, 1995
the long term, this would be preferable as privatised companies could want to raise further capital for expansion.

Accompanying this, as in the British experience, there is the whole question of informing and educating the general public - possibly through prolonged media campaigns - about privatisation. This is especially important as the average citizen would be relatively unsophisticated when it came to such matters.

As previously mentioned, there are those who claim that privatisation in Britain was a cause of unemployment, and in Egypt measures were taken to avoid unemployment as a result of privatisation. In Saudi Arabia, large scale unemployment of Saudis would be unacceptable. Unemployment, ideally, would need to be at the expense of the expatriate workforce. This needs a new realism if Saudis are to compete in the labour market. Third world expatriates perform menial tasks that Saudis are unwilling to do, semi-skilled jobs tend to be done by Asian expatriates who command much lower salaries and benefits than their Saudi counterparts and there are still not enough Saudis to take on the managerial and professional jobs. A profit motivated private sector employer would not want the burden of a relatively inefficient labour force. According to Azzam, accessibility to education does not need improvement, but quality does if Saudis are to cope with a change in market conditions. Although changes in attitudes are under way and new skills are continually being acquired, in the short term the government may need to ease the blow of privatisation until the labour force is in a position to compete.

1 - Henry T Azzam: Arab News, April 11, 1995
On a more positive note, "privatisation in Britain has relieved the state of what was the huge and growing burden of the investment needs and operating deficit of the public corporations. Second, it has raised substantial proceeds which have helped financing cuts and reduction in budget deficits, and thirdly and more generally, it has lead to increasing efficiency; improving competition and extending market disciplines." (1) This experience is as appealing to Saudi Arabia as it is to many other countries.

1 - Sir G. Howe: "Learning from the UK privatisation experience", in Privatisation & Economic Revival, Edited by E Butler, Adam Smith Institute, 1991, p. 28
Chapter Five

BACKGROUND TO PRIVATISATION IN SAUDI ARABIA
PRIVATISATION: The Early Experience

Privatisation requires the presence of a strong domestic private sector that is sufficiently competent and has adequate managerial and technical capabilities. This is essential for sustainable long term development. But, if the private sector is underdeveloped, with limited capabilities (as in the case of the Saudi Arabian private sector especially for the period 1970-1980) then direct foreign investment or contract management can provide an interim solution.

The inclusion of contract management and contracting-out provide a more flexible means of privatisation. If this definition is accepted, Saudi Arabia can be considered as one of the pioneer examples for pursuing privatisation.

The story of contract management dates back to May 29, 1933 when the Saudi Arabian Government signed the basic concession agreement with the Standard Oil Company of California (SOCAL) for the foundation of ARAMCO. In 1973, the Saudi Arabian Government acquired 25 percent of ARAMCO's crude oil concession rights, facilities and production. In 1974, the government increased that interest to 60 percent, and in 1980 it acquired the remaining 40%; ARAMCO is now entirely Saudi owned. ARAMCO was also contracted to carry out other projects on behalf of the government.

In February 1975, the government requested ARAMCO to prepare, design, construct and operate a programme to gather and process gas from ARAMCO's areas of operations. This Master Gas System became a backbone of Saudi Arabia's long-term industrial development programme.

ARAMCO was assigned by the government to plan, construct, manage and operate the Saudi Consolidated Electric Company (SCECO) in the Eastern
Province during the company's initial five years, effective January 1, 1977. SCECO is now an independent entity and the integrated network has been achieved.

Many services were also privatised through contracting out. For example, during the Second Development Plan 1975-1980, one of the major objectives was to increase private sector participation in municipal affairs by contracting the performance of certain municipal functions.

Contract management has obviously its own advantages among which, is that it relieves the government of the burden of non-viable state enterprises to improve the efficiency within the state enterprise sector. Another potential advantage is in obtaining services competitively from private contractors. This usually leads to better services that are more attuned to the needs of the people and with the benefit of lower costs.

In Saudi Arabia, like many other countries, contracting out or the granting of operating concessions can enable the government to retain its authority over a sector or industry, and may retain ownership of capital assets. The contractual relationship with a private operator injects into the relationship elements of profit maximising, at least when the government seeks these goals. While private companies, on the other hand, may prefer to act as contractor than as a partner. This enables them to avoid the risks of capital investment.
JOINT VENTURES

Industries with joint venture participants cover a wide spectrum, including construction, manufacturing, banking, maintenance and operation, shipping and petrochemical processing.

Joint ventures are developed either through successful business relationships or have been set up to bid on specific contracts. This usually takes place within the context of private foreign investment which can be direct or portfolio. Direct investment involves managerial control. Portfolio investments refer to the purchase of securities, and do not involve foreign control of the enterprise.

The launching of the Saudi Industrial Development Fund (SIDF) which provides capital loans for industrial ventures up to 50 percent of total investment cost, indicates the volume of commitment of Saudi Arabia’s government to the development of the private sector.

Joint-venture projects and direct foreign investments have the potential to offer the following benefits:

- Possible transfer of technology and introduction of new capital intensive industries.
- Greater choice of higher quality products at lower prices for domestic consumers.
- Further development of the private sector capabilities.
- Creation of employment opportunities and skills transfer.

The benchmark example of this arrangement in Saudi Arabia is SABIC. The Saudi Arabian Basic Industries Corporation (SABIC), was established in
1976, as a state-owned company aiming to set-up, operate and market products of basic industries based upon local hydrocarbon and mineral resources as well as other downstream and supporting industries. It also sought to encourage the private sector to invest and participate through the structure of joint ventures. In its initial stages of establishment, the government played a more direct role both in management and finance.

The paid up capital of SR 10 billion was divided into 100 million shares of SR 100 each, 70% owned by the government, and 30% by national citizens and other GCC members. Both are classified as private sector in the following table:

Table - 5.1

<table>
<thead>
<tr>
<th>STRUCTURE OF SABIC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Paid-up Capital</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Government</th>
<th>Private Sector</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid-up Capital</td>
<td>7,000,000</td>
<td>3,000,000</td>
<td>10,000,000</td>
</tr>
</tbody>
</table>

* As of December 1991
- In Thousands of Saudi Riyals

This direct involvement was essential in view of the large scale capital and other resources requirements and the long gestation period from planning to profitable operation of such projects. In any case, such major projects could not possibly be left entirely to the private sector because of the heavy risk factor which the private sector would not cover.

The intention to fully privatise this project was clearly out-lined in the Third Development Plan of Saudi Arabia 1980-1985 which stated:

"It is Government's intention that, when successfully established, a substantial proportion of SABIC's share in basic industries will be made
available for distribution to the Saudi public, including Saudi employees in these industries". (1)

By 1985 the plan was already put into action and a substantial proportion of SABIC shares was sold to the private sector in Saudi Arabia and in other GCC countries.

Table (5.2) illustrates the structure of SABIC industries and its affiliates.

By 1992 SABIC had almost doubled its production capacity:

"Total production in 1992 was 15.7 million metric tonnes (mt), up 19.8 percent from 13.1 million met produced in 1991. Sales volume in 1992, on a 100 percent basis (including downstream sales to affiliates)

<table>
<thead>
<tr>
<th>PRODUCTION (Thousand Metric Tons)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
</tr>
<tr>
<td>1991</td>
</tr>
</tbody>
</table>

SHIPMENTS (Thousand Metric Tons)

<table>
<thead>
<tr>
<th>1992</th>
<th>12,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>10,100</td>
</tr>
</tbody>
</table>

was approximately 12.5 million tons against 10.1 million tons in 1991. Comparable sales revenue was SR 14.5 billion ($3.87 billion) in 1992 and 13.4 billion in 1991 ($3.57 billion). Therefore, while sales volume on a 100 percent basis increased by 23.8 percent in 1992, sales revenue on a 100 percent basis increased by 8.2 percent, highlighting the fall in Petrochemical prices especially prices in 1992. The figures were in line with our expectations and highlight SABIC's ability to weather the cyclical downturn. for the third consecutive year we have paid dividends of SR 1 billion (SR 10 per share), continuing to maximize shareholder value". (2)

The total number of joint venture projects between the Kingdom and other countries was close to 1,161 in 1991 with 115 additional projects currently being implemented. The total capital invested in these projects amounted to SR 75 billion ($20 billion) of which SR 68 billion ($18.1 billion) was in

---

2 - SABIC Annual Report 1992
## SABIC INDUSTRIES & AFFILIATES

<table>
<thead>
<tr>
<th>AFFILIATE</th>
<th>LOCATION</th>
<th>PARTNERS</th>
<th>PRODUCTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>AR-RAZI</td>
<td>Al-Jubail</td>
<td>Consortium of Japanese Cos. led by Mitsubishi</td>
<td>Chemical Grade Methanol</td>
</tr>
<tr>
<td>Ibn Sina</td>
<td>Al-Jubail</td>
<td>Hoechst-Calanse and Panhandle Eastern USA</td>
<td>Chemical Grade Methanol, MTBE</td>
</tr>
<tr>
<td>SADAF</td>
<td>Al-Jubail</td>
<td>Shell, USA</td>
<td>Ethylene, Crude Industrial Ethanol, Ethylene Dichloride, Caustic Soda, Styrene</td>
</tr>
<tr>
<td>KEMYA</td>
<td>Al-Jubail</td>
<td>Exxon, USA</td>
<td>Polyethylene</td>
</tr>
<tr>
<td>Yanpet</td>
<td>Yanbu</td>
<td>Mobil, USA</td>
<td>Ethylene, Polyethylene, Ethylene Glycol</td>
</tr>
<tr>
<td>PETROKEMYA</td>
<td>Al-Jubail</td>
<td>No Partner</td>
<td>Ethylene, Polystyrene, Butene-1, Propylene, Butadiene, Benzene</td>
</tr>
<tr>
<td>SHARQ</td>
<td>Al-Jubail</td>
<td>Consortium of Japanese Cos. led by Mitsubishi</td>
<td>LLDPE, Ethylene Glycol</td>
</tr>
<tr>
<td>Ibn Hayyan</td>
<td>Al-Jubail</td>
<td>Lucky Goldstar Group of South Korea, NIOC, SAPPCO &amp; APLACO of Saudi Arabia</td>
<td>Viny Chloride Monomer, Polyvinyl Chloride</td>
</tr>
<tr>
<td>Ibn Zahar</td>
<td>Al-Jubail</td>
<td>Naste Oy, Finland, Ecofuel, Italy; APICORP, GCC</td>
<td>MTBE, Polypropylene</td>
</tr>
<tr>
<td>GASP</td>
<td>Al-Jubail</td>
<td>Other Saudi Producers of Industrial Gases</td>
<td>Oxygen, Nitrogen, Hydrogen</td>
</tr>
<tr>
<td>SAFCO</td>
<td>Dammam &amp; Al-Jubail</td>
<td>Private Saudi Shareholders &amp; SAFCO employees</td>
<td>Ammonia, Urea, Sulfuric Acid, Melamine</td>
</tr>
<tr>
<td>SAMAD</td>
<td>Al-Jubail</td>
<td>Taiwan Fertilizer Co., Republic of China</td>
<td>Ammonia, Urea, Type B Fertilizer</td>
</tr>
<tr>
<td>Ibn Al-Baytar</td>
<td>Al-Jubail</td>
<td>SAFCO</td>
<td>Ammonia, Granular Urea, Compound &amp; Phosphate, Fertilizer</td>
</tr>
<tr>
<td>HADEED</td>
<td>Al-Jubail</td>
<td>DEG, Germany</td>
<td>Steel Rebar Wire Coils</td>
</tr>
<tr>
<td>Sulb</td>
<td>Jeddah</td>
<td>Wholly owned subsidiary of HADEED</td>
<td>Steel Rebar</td>
</tr>
<tr>
<td>Alba</td>
<td>Bahrain</td>
<td>State of Bahrain; Brenton, Germany</td>
<td>Aluminium Ingots, Slabs and Billets</td>
</tr>
<tr>
<td>Garmco</td>
<td>Bahrain</td>
<td>Bahrain, Iraq, Kuwait, Oman, and Qatar</td>
<td>Aluminium Sheets</td>
</tr>
<tr>
<td>Gipic</td>
<td>Bahrain</td>
<td>Kuwait and Bahrain</td>
<td>Ammonia, Methanol</td>
</tr>
</tbody>
</table>

industrial projects and SR 7 billion ($1.9 billion) in non-industrial projects. The United States of America is the Kingdom's leading joint venture partner among the industrialized countries as it was involved in projects with capital invested of SR 10,611 billion ($2,829 million) in more than 62 industrial and 124 non-industrial projects. \(^{(1)}\)

The United States was followed by Panama with total capital invested in joint venture projects of SR 8,521 million ($2.27 billion), Germany is the next with investment of SR 5,141 million ($1,371 million), followed by Bermuda with SR 2,580 million ($688 million). The case of Panama and Bermuda could be attributed to the fact that a number of multinational companies are registered there benefiting from a relaxed business atmosphere in terms of regulations and taxation. \(^{(2)}\)

Japan has participated in 40 joint venture projects with a total investment of SR 2,412 million ($643 million), only 8 of which are industrial. This does not include Japan's share in the Arabian Oil Company operating in the Neutral Zone. Joint ventures involving the U.K. until 1991 had a total capital of SR 2,092 million ($558 million). Other participants include South Korea SR 2,028 million ($541 million), Switzerland SR 1,765 million ($471 million), France SR 1,469 million ($389 million), and Italy SR 1,332 million ($355 million).

It is believed that the participation of America and Britain, in particular, has increased considerably over the last two years as the offset programme started. The offset investment programme was introduced in the Kingdom to ensure that Saudi Arabia benefits substantially from the large defense

contracts that were awarded to foreign suppliers. The participating countries are expected to offset the cost to the Saudi Government by investing 35% of the contract value in joint ventures in the Kingdom.

Foreign investment in the Kingdom is concentrated in petrochemical industries, building materials and minerals which together contributed to more than 96% of total foreign investment.

The magnitude of such participation indicates the following:

- The government support and encouragement to industrialisation.
- The government commitment to a free economy and free trade.
- That business opportunities in Saudi Arabia are varied and particularly rewarding.
- Such developments will have a progressive impact on the growth and contribution of the private sector.
- The presence of a sizable number of the labour force in the Kingdom as a result of such programmes.

Joint ventures have expanded and developed as a result of the numerous superb facilities including reliable physical infrastructural support, provision of credit for export and equal treatment to foreign investors, tax exemption and free movement of the repatriation of profit or foreign currency transactions.

In overall terms the contribution that joint ventures have made in terms of developing the private sector in Saudi Arabia is in skills and capabilities; technology transfer; and the changes made on business laws and regulations. These have paved the way directly or indirectly to full scale privatisation.
What may be required is to absorb the existing structure within the future plans for privatisation.

RECENT INITIATIVES AND THE GOVERNMENT’S OBJECTIVES

The word “privatisation” as announced policy, appeared for the first time in the Fourth Development Plan document which considered privatisation as a key area for joint government-private sector participation in development.

Privatisation has been regarded as a basic strategic principle of the plan, by which the private sector will be given the opportunity to undertake many of the economic tasks of the government. It will also be provided with the opportunity to acquire, manage and operate projects currently operated by the government, providing that this will result in lower cost.

“During the Fourth Plan the government will continue with its programme of transferring ownership of government corporations to the private sector. A further issue of SABIC shares has already been announced and the government is giving careful consideration to the timing and proportion of shares that could be offered in other government corporations and institutions”. (1)

During the Fifth Plan period (1990-1995) privatisation is given renewed emphasis with the intention of producing a higher level of efficiency and innovation and greater economic benefits in particular sectors.

If privatisation is effectively introduced it can contribute to a number of key goals of the plan. These include: increasing private sector investment in the economy; increasing economic efficiency and innovation; increasing

---

competition; reducing subsidies; and encouraging a wider distribution of ownership of economic resources.\(^{(1)}\)

The plan also describes the forms of privatisation that will take place. These include, contracting out of services, and increase of the number of leading businessmen on government boards of government owned enterprises. It also recommends a development of privatisation strategy in consultation with the private sector. Government-owned companies will be classified into four categories, according to the scale of possible private sector participation.

- strategic activities that will remain as a government responsibility.
- government activities to be transferred completely to private sector ownership and management.
- government activities where joint venture ownership and management with the private sector will be encouraged.
- service activities that can be contracted out to the private sector, or where other private sector participation methods can be implemented.\(^{(2)}\)

The longer term objective as suggested by the plan is for the private sector to have 70 to 80 percent ownership in most joint ventures and also to introduce commercial discipline to the operation of joint venture and government-owned companies.

Such strategic development would rapidly reverse the excessive extended role of the public sector by turning over to private ownership the large enterprises that the government developed and supported. Furthermore, the privatisation

---

\(^{(1)}\) - Ministry of Planning: Fifth Development Plan 1990 - 1995, p 146
programme is expected to play an effective role in resolving the budgetary deficit.

The more the private sector becomes self-reliant this will lead to an immediate benefit, which is the reduction of subsidies. For many years the extensive subsidy system in the Saudi economy, despite having effectively achieved its objectives, has also caused various forms of market distortion. This includes excessive consumption and wasteful utilization of health and other social services. In addition subsidies, such as those for real estate development, have already outlived their usefulness, as the housing shortages have been virtually eliminated in most parts of Saudi Arabia.

The reduction of subsidies will decrease the burden on the public budget and may lead to economic efficiency through re-deployment of resources. Also the growth and development of the private sector through privatisation could create new employment opportunities.

It may seem strange to bring such a suggestion to the discussion when privatisation is, paradoxically, responsible for unemployment once a project is privatised and new management start cutting staffing in attempts to reduce operational expenses. Once a project is privatised, it will immediately be subjected to a complete process of restructuring in order to economize and make it efficient and competitive.

However, in Saudi Arabia unemployment has never been a problem. On the contrary, during the last two decades, total employment has grown at an average annual rate of 8 percent, and 4.3 million new workers have been added to the work force over this period. The problem is that most of this number was absorbed in the government sector.
In this situation of surplus employment, privatisation will help to balance the various manpower issues. Some of these issues have already been targeted by the Fifth Development Plan.

These include:

- Reduction of 220,400 non-Saudi workers mainly in the private sector.
- Employment of 213,500 Saudis during the plan period (1990-1995) in the private sector which is expected to absorb 96% of total civilian employment; and thus, enhancing Saudization.

Upgrading manpower efficiency, through improving the effectiveness of education and training system, and eliminating excessive dropout rates and repetition.

Moreover, and maybe most importantly, privatisation is introduced to increase economic efficiency. Such a benefit is both not easy to measure nor to attain. It usually takes considerable time before tangible benefits can be calculated in this regard. The importance of increasing economic efficiency comes from the wider aspect of improvement that touches almost every aspect of production and utilisation of resources.

The improvement of economic efficiency is usually achieved through:

- The introduction of appropriate management control.
- Technological innovation.
- Creation of competitive environment.
- Restructuring of business and reform and thus elimination of waste.
Through the privatisation initiative, the private sector is expected to contribute about SR 144 billion of total investment in the Fifth Plan.

This will allow for effective mobilization of the private sector’s financial assets and the development of a domestic capital market. The expected benefit is a decline in the role of the government budget as a major source of financing and consequently provision of new sources of funds to help resolve the budget deficit problem.

This reduction will lead to long-term stabilization of the economy, through stable government expenditure, and avoiding sharp increases and decreases in the budget.

Privatisation will also enable the government to achieve wider distribution of wealth. This is both an economic objective as well as an objective with some social implications. Privatisation is currently a stronger attraction for its ability to widen participation and broaden the scope of private ownership and distribution of income.

**The Saudi Arabian Approach To Privatisation**

The optimal sequencing of privatisation usually begins by market and trade liberalisation which lead to competition, export promotion, exchange of goods and acceptance of foreign capital.

Free trade in particular will have the advantage of forcing the state monopolies, such as Saudi Airlines or Grain Silos, to be competitive in the world context. The pressure of competition would require that private enterprises search out opportunities to make profits in order to minimize the risk of take-over and hence they have to improve their productive efficiency.
Liberalisation is unlikely to successfully foster competition unless accompanied by regulations to deter anti-competitive practices. In the case of a public enterprise, this may require cutting off access to government financial resources to finance such practices. At the same time, financial reform prior to privatisation, including the development of banks and stock market efficiency are essential in order to ensure optimal allocation of available funds.

The examination of the Saudi Arabian approach shows a logical sequence of actions prior to full-scale privatisation. The steps that were implemented include:

1. Continuous government support to the private sector including loan offering, technical aid, exemption from customs fees, land and services.
2. Modernization of the regulatory system by introducing the Saudi Tax Code and detailed company regulations.
3. Development of national banks and the stock market.
4. Introduction of privatisation gradually, on a selective and mostly contract-management basis.

In Saudi Arabia, this pattern was adopted because the private sector was not adequately developed. The government, at the same time, is the major recipient of cash inflow. The government participated jointly with private enterprise where this was necessary to develop lead industries in critical sectors and then divested as soon as feasible. The government provide the private partner with financial support and protection which is needed for future growth.

Also, the social implications of projects is always taken into consideration. This is demonstrated in the cases of King Abdul Aziz University in Jeddah
and Prince Salman Hospital in Riyadh. Both started up as private enterprises with government support, and when they became non-profitable they were governmentalized.

These indicate that privatisation in Saudi Arabia will be a means of economic efficiency and social stability, not an avenue for solving problems of government finance. Privatisation is not a substitute for reducing public expenditure or increasing tax revenue.
Chapter Six

Attitudes of Private Investors Towards Privatisation in Saudi Arabia
INTRODUCTION

This chapter describes, in more detail, the methodology used to conduct this study, and presents a complete analysis of the views, opinions and attitudes of the Saudi private investors towards privatisation in Saudi Arabia. The hypothesis to be tested in this context, and around which the objectives of the survey are developed, is that "attitudes of the Saudi businessmen towards privatisation are generally very positive and supportive" but there might be variation in opinion with respect to private sector capabilities, business environment, and procedures for investment which require some investigation to determine their consistency. One may ask why. The advantage of this exercise lies in the fact that if this consistency is established, the degree of accuracy of their answers is likely to be higher and consequently is more dependable for making decisions. The consistency can be used as a factor for judging how well-informed the businessmen are about privatisation issues.

From the result, it appears, there are no strong arguments, as such, in terms of "for" and "against" of all issues presented and discussed in the survey. Like many public opinion surveys, the results are rather straightforward and there is no need to contradict its findings as all information can be used only as an indicator of the general attitudes of the private investors towards privatisation.

This chapter is organized into seven sections following the structure of the questionnaire. As previously explained, each section is designed to discuss and analyse one particular aspect, such as support, timing, advantages, disadvantages and constraints to privatisation.
METHODOLOGY

As outlined in chapter one, various research approaches were adopted in conducting this study. In developing the conceptual framework of this study, an extensive review of the literature, including books, journals, business reports and official documents, was carried out. The questionnaire was used to assess public officials and private businessmen's perceptions pertaining to business environment, opportunities, potential projects for privatisation, timing and constraints. This was also supplemented by interviews with a sub sample composed of public officials, consultants and businessmen. The selection of this group was based on relevance of their business or work to the nature of the subject under discussion. All participants are included in the 47 survey population. The purpose of these interviews was to provide clearer and more in-depth answers to some of the questions addressed by the questionnaire.

In order to obtain specific answers and also to clearly indicate to the participants the aim of the questions under each section, the questionnaire was deliberately divided into sections. The questionnaire comprised both close-ended and open-ended questions. Whenever needed, validity of the content was determined by submitting a draft copy to different individuals in the private and public sector to seek their advice on the clarity of the questions and their relevance. The validity of the question was also determined by the frequency of the questions. Certain questions were asked twice in different formats.
TREATMENT OF THE SURVEY DATA

Each of the survey booklets is composed of seven sections as follows:
- Support and attitudes
- Benefits
- Dis-advantages
- Timing
- Constraints
- Business environment
- Mechanics and structure

The processing of this survey required the design of the following computer programmes:
- A data entry programme that will capture all data.
- Programme to do the counting of the responses for each questions and coming out with a summarized file containing the percentage calculation.
- Printing programme to generate the survey summary report showing only those selected data.

Each of the survey booklets has been assigned an ID number that will be used as a key to update each survey record.

GENERAL CHARACTERISTICS OF RESPONDENTS

The questionnaire included a separate section as a profile to provide information about the respondents, such as age, educational background, experience, nature of business and the location of their businesses. This information has been used as a criteria in the analysis of the views of each business group separately e.g. industry, agriculture.
AGE OF RESPONDENTS

The data shown in table (6.1) reveals the age of respondents which indicates that the respondents age ranged between 30 to 60 years, with 34.0% between 30-40 years of age and 32.0% between 40 to 50 years of age. Thus the majority of respondents were between 30-50 years of age, which is close to the normal distribution of the targeted population.

Table - 6.1
FREQUENCY & PERCENTAGE OF RESPONDENTS
RESPONSES TO AGE

<table>
<thead>
<tr>
<th>Age</th>
<th>Freq.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 years or less</td>
<td>3</td>
<td>6.0</td>
</tr>
<tr>
<td>31 - 40 years</td>
<td>16</td>
<td>34.0</td>
</tr>
<tr>
<td>41 - 50 years</td>
<td>15</td>
<td>32.0</td>
</tr>
<tr>
<td>51 - 60 years</td>
<td>4</td>
<td>9.0</td>
</tr>
<tr>
<td>Total</td>
<td>38</td>
<td>81</td>
</tr>
</tbody>
</table>

No response : 9

EDUCATION

The respondents were asked to indicate their formal educational background. It ranged from high school or less to post graduate levels. Based on Table (6.2), it was found out that 6.0% had secondary level, 43.0% are university graduates and 40.0% had post graduate level. Therefore the majority of respondents had a college education. This indicates that the respondents were very well educated which qualifies them to understand and deal with the required task.
Table - 6.2
FREQUENCY & PERCENTAGE OF RESPONDENTS EDUCATIONAL BACKGROUND

<table>
<thead>
<tr>
<th>Formal Education Level</th>
<th>Freq</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td>Intermediate</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Secondary</td>
<td>3</td>
<td>6.0</td>
</tr>
<tr>
<td>University Graduate</td>
<td>20</td>
<td>43.0</td>
</tr>
<tr>
<td>Post Graduate</td>
<td>19</td>
<td>40.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>43</strong></td>
<td><strong>91.0</strong></td>
</tr>
</tbody>
</table>

No Response : 4

YEARS OF EXPERIENCE

The data taken from the respondents showed between 5 to 35 years of experience. As shown in the table (6.3), it was found out that 15.0% had between 5 to 10 years experience, 32.0% between 10 to 15 years experience, 9.0% between 15 to 20 years experience, 21.0% between 20 to 25 years of experience, 6.0% between 25 to 30 years of experience, while 4.0% had between 30 to 35 years of experience. Therefore, the majority of respondents have 10 to 25 years of experience. This is, again, another positive indicator of the quality of the respondents and consequently the reliability of their answers.
Table - 6.3
FREQUENCY & PERCENTAGE OF EXPERIENCE IN YEARS

<table>
<thead>
<tr>
<th>Experience in years</th>
<th>Freq.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 years or less</td>
<td>7</td>
<td>15.0</td>
</tr>
<tr>
<td>10 - 15 years</td>
<td>15</td>
<td>32.0</td>
</tr>
<tr>
<td>15 - 20 years</td>
<td>4</td>
<td>9.0</td>
</tr>
<tr>
<td>20 - 25 years</td>
<td>10</td>
<td>21.0</td>
</tr>
<tr>
<td>25 - 30 years</td>
<td>3</td>
<td>6.0</td>
</tr>
<tr>
<td>30 - 35 years</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Total</td>
<td>41</td>
<td>87.0</td>
</tr>
</tbody>
</table>

No response : 6

LIMITATION OF THE STUDY

Privatisation is a politically sensitive issue. In theory it is a desirable goal, in practice many issues have to be considered carefully, especially with regard to what can be privatised and what can not be privatised, when and how. Also, this decision requires an assessment of the public sector performance and efficiency prior to the making of definite conclusions. These require intensive research and are almost impossible to carry out accurately in a conservative society like Saudi Arabia where information is very difficult to obtain and people are very sensitive to criticism. This study is limited in the sense that such evaluation is not available or made. On the same basis, the opinion of foreign partners, which is a valuable part, was excluded. They have actually a major stake in implementing a successful privatisation programme. The private sector would need both their expertise and finance.
As mentioned earlier, Saudi Arabia has some privatisation activities. Their creation is not necessarily an outcome of well designed plans but born and raised in their own time and circumstances as a result of a growing need in the form of contracting services or sale of part of the enterprise. There is no privatisation plan except what has been announced in the development plan documents, and even then, there is no specific mention of how this can be implemented, when or by whom. This limited the study in terms of assessing returns or efficiency improvements of privatised projects or activities as a case study.

**Analysis of Data and Survey Results**

**OVERALL SUPPORT AND ATTITUDES**

The private sector is the key role player in privatisation. This is because the private sector’s initiative, skills and finance are essential requirements for successful implementation of privatisation. This section seeks to establish how much support will be provided by the Saudi businessmen to this programme.

![Figure 6.1: General Support for Privatisation](image)
From the survey, it is observed that within the sample size, 91% of the respondents support the idea of privatisation, as shown in figure (6.1). This, at the outset, confirms the first aspect of the hypothesis that privatisation will be widely accepted. The result is consistent with a similar field survey, by the Saudi Chamber of Commerce and Industry, which was carried out in 1990 and showed that exactly 91 percent, out of a total of 140 interviewed, supported privatisation. However, out of all the investors studied, 64% support privatisation on a large scale and the remainder, i.e. 36 %, on small scale as shown on Figure (6.2).

Figure - 6.2

SUPPORT FOR INTRODUCTION SCHEMES

This does not necessarily reflect a well-informed understanding of the appropriate scale of privatisation as international experience shows preference for gradual small-scale privatisation that is built on success. This sustains reliable long term development. Therefore, support for large scale
privatisation may confirm the availability of funds in the private sector to buy large development projects and that the private sector capabilities for investment and participation have been developed.

This assumption is consistent with the objective of the Fifth Development Plan which calls for the private sector to be a lead-factor in the future development of Saudi Arabia.

"The private sector has now reached a stage which will allow for its more effective participation in the Kingdom's development. Of over-riding importance in this regard is the need to stimulate a net inflow of private capital from abroad (and from within the Kingdom) to engage in development projects and increase the level of foreign direct investment in the Kingdom". (1)

The Businessmen's Perspective of Privatisation Objectives & Benefits:

The private investors' opinions with respect to objectives and benefits of privatisation were sought through the field survey. The majority of the answers support privatisation, for a variety of reasons as shown in table 6.4. Those objectives were initially identified through open-ended questions and then all answers were validated in terms of frequency in order to rank those objectives in terms of preference and priority.

Table - 6-4
EXPECTED BENEFITS OF PRIVATISATION IN SAUDI ARABIA

<table>
<thead>
<tr>
<th>Category</th>
<th>Agreed</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in economic efficiency</td>
<td>34</td>
<td>72%</td>
</tr>
<tr>
<td>Improvement in quality service</td>
<td>36</td>
<td>77%</td>
</tr>
<tr>
<td>Growth of the private sector</td>
<td>31</td>
<td>66%</td>
</tr>
<tr>
<td>Expansion of services</td>
<td>25</td>
<td>53%</td>
</tr>
<tr>
<td>Competition</td>
<td>31</td>
<td>66%</td>
</tr>
<tr>
<td>Increase government revenues</td>
<td>23</td>
<td>49%</td>
</tr>
<tr>
<td>Development of small businesses</td>
<td>21</td>
<td>45%</td>
</tr>
<tr>
<td>More distribution of wealth</td>
<td>35</td>
<td>74%</td>
</tr>
</tbody>
</table>

From the survey, it is clear that respondents placed special emphasis on improving the quality of services as top priority with 77% of the total support. The quality improvement of services of privatised projects usually comes as a result of changes in management control and the submission of such projects to competitive forces and the discipline of the private capital market. Improvement in quality, normally, is associated with increase in the economic efficiency of a project, which is a primary target for privatisation.

This emphasis on quality of service may reflect the dissatisfaction of the private user, individual or company, with the standard and reliability of some monopolies which are operated by the government, like Saudi Arabian Airlines or postal services. However, there is no "guarantee" as such that the quality of service will automatically improve if a project is transferred to private ownership. There have been cases where this transfer was merely a change of status from public monopoly to private monopoly.
The remainder of the expected benefits includes increases in economic efficiency with agreed percentages of 72%, growth of the private sector 66%, competition 66% and more distribution of wealth 74%. Such objectives are very typical. They usually form the basis of the economic rationale for privatisation in all countries. However, what seems to be of significant importance in this context, is the question of whether privatisation will actually lead to a real growth of the private sector and private investment or not.

Historically, private investment has received government support from the very beginning. The generosity of this support covers a wide spectrum of privileges. These include subsidies, export promotion, protection, and the provision of various facilities. This is an important factor in the development of the Saudi Arabian economy as a whole. It reflects, at the same time, that the government is not only committed to such development but is prepared to release some of its business to the private sector at one stage or another. But in the absence of the government’s extended support, subsidies and protection, two questions need to be answered:

Is the private sector ready for privatisation?
Does the private sector have adequate finance to buy?

Those questions where specifically addressed in the survey which revealed that 81% of the respondents think that the private sector has adequate finance to buy large government monopolies. Such a finding is confirmed through the experience of the Fourth Development Plan period 1985-1990 with its own marked slow-down in economic activity, which showed the private sector becoming less dependent on government expenditure. Despite the absence of
growth in the overall economy, the private sector identified and developed new businesses. Their importance and contribution to the overall development of the Saudi economy, as yet, need to be assessed.

However, for a large programme of privatisation, investment by institutions (banks, trusts and insurance funds), rather than individuals, is essential, if not inevitable.

"In market economies, institutional investors are quite the most prominent types of investor. In the United Kingdom, for instance, almost two-thirds of all publiclyquoted shares are held by institutional investors. In Japan and Italy institutions hold more than three-quarters of all shares. And institutional investors hold about one-half of the total value of shares quoted on the New York Stock Exchange, with pension funds alone accounting for more than 10 percent". (1)

The private institutions are expected to contribute about 144 billion of total investment in Saudi Arabia during the period 1990-1995. Financing of this investment will come primarily from retained earnings of private companies, commercial bank loans and private capital brought back from overseas.

In the past, only a small fraction of this resource has been invested in the Kingdom. This is mainly due to difficulties in finding new business opportunities, given the relatively small domestic market.

Thus privatisation is expected to lead to a chain of benefits that are targeted for the long term development of the private sector, including the opening up of new business opportunities, development of the domestic financial market,

---

1 - P. Marer and S. Zecchini: The Transition to a Market Economy, OECD, p. 33
encouragement of competitiveness, effective mobilisation of capital and resources, and achievement of a high-rate of returns to different investors.

The increase of business opportunities will consequently have an impact on the development of small business. This is very important to the Kingdom, not only for the contribution that this type of business makes to the creation of employment but also for regionalization and franchising and distribution of services, given the huge area that Saudi Arabia occupies. The views of the respondents, in respect to the impact of privatisation on the development of small business, were examined. And the survey reveals that 77% were of the opinion that privatisation will have a very positive effect on these businesses as illustrated in table (6.5).

<table>
<thead>
<tr>
<th>IMPACT OF PRIVATISATION ON THE DEVELOPMENT &amp; GROWTH OF SMALL BUSINESS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Agreed</strong></td>
</tr>
<tr>
<td>Very positive</td>
</tr>
<tr>
<td>Negative</td>
</tr>
<tr>
<td>No impact at all</td>
</tr>
<tr>
<td>I don't know</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Small enterprises are believed to be a fruitful source of jobs. It is very reasonable for many governments in developing countries to promote them, or to desist from destroying them, for that reason alone. Moreover, the development of small business is encouraged by the Fifth Plan initiative in order also to reduce average production costs through economies of large
scale production, improve competitiveness and promote greater financial strength.

ATTITUDES TOWARDS INVESTMENT AND PARTICIPATION IN PRIVATISED PROJECTS

The attitudes towards investment in privatisation was examined in terms of utilization of savings, direct foreign investment, and public share holding. Such data is given as follows:

Investment of Savings in Privatisation

From Figure (6.3), it is observed that 21% of participants are prepared to invest up to 20% of their total savings and another 19% of investors were prepared to invest up to 50% of their savings. There are also another 23% of businessmen who were prepared to invest up to 30% of their total savings. This indicates that the majority of private investors will accept and share the capital and organisation risks of privatisation.

Figure (6.3)

INDIVIDUAL SAVINGS TO BE INVESTED
Although the responses in the survey must be accepted as representing only the views of those questioned, perhaps the results don’t fully reflect the reality of what would occur if privatisation took place. Hypothetically, businessmen may say they are willing to invest large sums in Saudi privatisation programmes - but they can only make that decision when privatisation is a fact. Only three years after the Gulf War, many Saudis may feel that investments in other parts of the world are safer or more profitable. It is only natural for businessmen to support their country. When asked hypothetical questions, they may tend to respond positively about anything seen as in the Saudi interest, but when it comes to the crunch, there is the suspicion that these views may not be supported by cash.

However, these results can generally be associated to another finding regarding business opportunities in Saudi Arabia. The study revealed that 66% of all businessmen interviewed think that the business opportunities in Saudi Arabia are very rewarding, which explains their readiness for participation.

In terms of financial capabilities, 53% of respondents think that the private sector has adequate financial resources in the Kingdom for such investment, and another 45% of investors think that the private sector owns large amounts of reserves outside the Kingdom. This indicates that the financial infrastructure is there and the time may be right. This assumption is again consistent with the overall objectives of the Fifth Development Plan which acknowledge: that:

“Private sector capital represents a very important under utilized resource for the Kingdom, and the success of future economic development depends
on including a much greater deployment of this resource in the Saudi and GCC economies". 

**Direct Foreign Investment**

Private foreign investment is usually an important mechanism that leads to a flow of financial resources mostly by large multi-national corporations with headquarters in the developed nations. This is very important to many developing countries which are short of such resources. In the case of the Saudi Arabian economy, the situation is reversed. At one point of time there was an excessive surplus of such resources that led to the creation of inflationary pressures, which urged the government to undertake a full-scale employment of this financial surplus on development projects. Direct foreign investment in Saudi Arabia received early and continued support from the government for different reasons than those in other developing countries. The main reasons include technology transfer and the creation of the new generation of modern industry.

Figure (6.4)

**ATTITUDES TOWARDS DIRECT FOREIGN INVESTMENT**

The attitudes of private investors were assessed to examine the acceptance of participation of foreign companies in privatisation. Figure (6.4) shows that: 40% of Saudi businessmen are with the idea that such participation should be allowed unconditionally, 45% feel that it should be allowed but controlled, and 15% are of the opinion that it should not be allowed at all.

Therefore, it can be concluded that there is majority support for direct foreign investment. Such a positive attitude has developed over the years through successful business partnerships and the continued encouragement of the state.

Unfortunately, this study does not cover the views of the expatriate partners with regard to privatisation and investment. Such limitation perhaps requires further investigation and may have to wait the outcome of other studies.

Public share-holding

From the data collected, it was observed that 89% of the potential investors support the idea of large scale public share holding, as shown in Figure (6.5).

**Figure (6.5)**

<table>
<thead>
<tr>
<th>Attitudes Towards Public Share Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Scale</td>
</tr>
<tr>
<td>Restricted</td>
</tr>
<tr>
<td>Small Scale</td>
</tr>
</tbody>
</table>

Large Scale 89%
Restricted 2%
Small Scale 9%
The domain of public share holding was also investigated. The pattern illustrated in Figure (6.6) shows the variation of attitudes in this respect.

**Figure (6.6)**

**ATTITUDES TOWARDS PUBLIC SHARE-HOLDING BASED ON DIFFERENT NATIONALITIES**

- 32% feel it should be restricted to Saudis only.
- 30% feel it should be open to Saudi & other Gulf States citizens.
- 13% are of the opinion that it should be open to all Arabs.
- 23% think it should not be restricted.

At first sight, the above results with regard to the categories “Saudis and All Arabs” and “Not-restricted” may seem strange and contradictory. In reality, the results probably reflect the fact that Saudis, in general, feel a strong affinity with other Gulf Arabs but this is not the case with the rest of Arab World. Businessmen would see opening investment to anyone, rather than Arabs in general, as more beneficial from an economic point of view.
The conclusion, that can be made on the basis of information regarding both direct foreign investment and the structure of public share holding, is that foreign nationals should be included in participating in all privatised projects. In practice, there are obvious contradictions of policies. While the government support private foreign investment, in many privatised projects share holding is restricted to Saudis only and in a few cases, participation of the Gulf States members is allowed.

**Role of the Government & Funding**

The relationship between the government and the private sector is a very important issue both prior to and after privatisation. This is because public and private interest must work in harmony for future growth and sustainable development. The perception of the Saudi businessmen was analysed in this respect. The results gathered indicate that 68% of the respondents agreed that the government should retain some shares in privatised projects in order to ensure control. This will help in preventing the replacement of public monopolies by private monopolies as well as protecting the interests of the beneficiaries, especially in services such as health or education. Government control is seen as especially important in oil resources in particular. Seventy-nine percent reacted that control over natural resources such as oil and mineral wealth should be in the hands of the government only. The genuineness of this reaction is questionable, and there is a possibility that the respondents reacted that way because they know that the government will not, understandably and naturally, privatise this sector, because it is the only source of income for the government. There is also a possibility that this reaction is given in view of the huge expense required for this kind of investment. The latter can be disputed firstly by the fact that privatisation of
this sector can be through investment institutions and groups and not necessarily individuals. Secondly, on the basis that business, by its nature in Saudi Arabia, is family business with a strong history of large capital sums and active involvement in investment projects overseas. This assumption about the similar accuracy of their statement with regard to privatising the oil sector is confirmed in the analysis of data. There was an obvious contradiction. While seventy-nine percent said the government should have entire control over oil resources, almost half of the respondents (45%) agreed that Saudi ARAMCO should be privatised.

On the other hand, the introduction of privatisation usually requires deregulation and removal of protection laws as well as the reduction of subsidies, so that reliance on the private sector capabilities can be made. The collected data confirmed that such understanding is well established within the business community. The survey showed that 64% agreed that with privatisation, government funding to the private sector should be reduced. This comes in conformity with government policy which urges both during the Fourth, Fifth and Sixth Development Plans.

**Business Environment**

A necessary condition for enhancing privatisation is the availability of an organised, secure, and efficient business environment. This comprises an adequate financial system, good business law, sophisticated banking system and stock market. Some of these facilities have already been discussed in chapter three. The purpose of this discussion is to examine the view of respondents with respect to the business environment in Saudi Arabia. Are
they satisfied with these services? Does it provide them with the necessary support?

Fifty-seven percent of the business sample, when asked about the appropriateness of the financial market to the task of stimulating privatisation, indicated that they perceive the market as unorganised, and only 43% were of view that it is organised.

This result is consistent with next finding where 43% of the respondents indicated that the financial market provides them with the adequate support, and the remaining 53% are in disagreement. This consistency is indicated in the following table:

Table - 6.6

<table>
<thead>
<tr>
<th>BUSINESSMEN'S PERCEPTIONS OF THE FINANCIAL MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
</tr>
<tr>
<td>Organised</td>
</tr>
<tr>
<td>Un-organised</td>
</tr>
</tbody>
</table>

Their view was also examined with respect to business law. While the picture drawn about the financial market is generally acceptable, the variation of answers with regard to business law indicates that only 11% of respondents think business law in Saudi Arabia is comprehensive, another 23% think it is generally adequate and the remaining 64% believe it is not adequate, reflecting dissatisfaction.

This result has been compared to a similar survey and found to be compatible. Wahib A. Soufi and Richard T. Mayer conducted a series of structured interviews in the western region of Saudi Arabia with (similar number to this
survey population) about fifty randomly selected chief executives in the formal manufacturing sector. Eighty-two percent indicated that they perceive business law to be counter-productive in encouraging businessmen to invest in industrial projects. In addition, seventy-six percent said they thought these laws and regulations do not protect the interests of industrial firms. (1)

POTENTIAL PROJECTS FOR PRIVATISATION

The identification of the appropriate projects for privatisation is of crucial importance. The question of what can be privatised, and what can not be privatised needs to be addressed carefully and selectively.

Different considerations need to be taken into account in this process of selection including the status of the proposed project for privatisation, the immediate and long term benefit, the impact on manpower in terms of costs and reduction.

Examples in different countries show that the first projects which are usually identified for privatisation are those which can be considered as the unprofitable businesses. Their economic performance is ineffective, and they are so often an extra burden on the public budget, yet they enjoy state protection. But while the above description may be a correct account of their financial position, usually their economic profitability can be improved if they are introduced to the capital market forces, competition and reforms. The reform process includes the introduction of new management and control procedures and restructuring of their business.

---

In the survey the question of what can be privatised and what can not be privatised was addressed specifically and the respondents expressed their support for a variety of government projects as illustrated in figure (6.7):

Table - 6.7

PROPOSED PROJECTS FOR PRIVATISATION IN SAUDI ARABIA

<table>
<thead>
<tr>
<th>Proposed Project</th>
<th>Agree</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabian Airlines</td>
<td>44</td>
<td>0</td>
</tr>
<tr>
<td>Gen Orgn for Rail Roads</td>
<td>39</td>
<td>3</td>
</tr>
<tr>
<td>Gen Orgn for Soil &amp; Grains</td>
<td>22</td>
<td>17</td>
</tr>
<tr>
<td>Saudi Telecommunications</td>
<td>42</td>
<td>2</td>
</tr>
<tr>
<td>Hospitals</td>
<td>27</td>
<td>13</td>
</tr>
<tr>
<td>Universities</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Postal Services</td>
<td>30</td>
<td>11</td>
</tr>
<tr>
<td>Sea Ports</td>
<td>26</td>
<td>15</td>
</tr>
<tr>
<td>Airports</td>
<td>22</td>
<td>19</td>
</tr>
<tr>
<td>Saudi ARAMCO</td>
<td>21</td>
<td>22</td>
</tr>
</tbody>
</table>

The figures depict that Saudi Arabian Airlines and Saudi Telecom respectively are strongly nominated for privatisation. Similar findings, in another report, reveal that both Saudia and Saudi Telecom are favoured for privatisation above any other projects. The result of this survey indicates this preference as follows:
Table - 6.8
FREQUENCY & PERCENTAGES OF RESPONSE OF “STRONGLY FAVOUR” TO ITEM DESCRIBING PUBLIC ORGANISATION & ENTERPRISES AS CANDIDATES FOR PRIVATISATION

<table>
<thead>
<tr>
<th>Item Option</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Freq</td>
<td>%</td>
<td>Freq</td>
</tr>
<tr>
<td>Saudi Arabian Airlines</td>
<td>113</td>
<td>80.7</td>
<td>143</td>
</tr>
<tr>
<td>Saudi Telecom</td>
<td>112</td>
<td>87.1</td>
<td>151</td>
</tr>
<tr>
<td>Saudi Public Transport Company</td>
<td>127</td>
<td>90.7</td>
<td>180</td>
</tr>
<tr>
<td>Saudi Electricity Company</td>
<td>116</td>
<td>82.9</td>
<td>169</td>
</tr>
</tbody>
</table>


This suggestion is not unique to Saudi Arabia. As discussed earlier, the examples drawn from Malaysia, and Jordan showed that the national airline, the postal services, and telecom are the first to be privatised. This is not only because they are loss making businesses, but because they are, by the nature of their business, potential money making projects. Besides, such projects involve large operational expenses that can be a heavy burden to the public budget. They can be introduced to the competitive market. And they are not a pure welfare service that is offered only, for example, to the sick, elderly or the orphan, therefore their social value does not require state control or continuous intervention.

In respect to the official plan, the government already announced that further shares of SABIC will be offered to the public during the period 1990-1995 and that investment opportunities will be made available to the private sector in basic and down stream petrochemical projects, in petroleum refining and in
projects within the offset programme. There is no specific reference in the plan document to any of the favoured enterprises in the survey which reflects a contradicting view in the matters.

However, like the ARAMCO example, there is an obvious "inconsistency" with regard to what can not be privatised. While 57% of respondents agreed that hospitals should be privatised, in another situation 64% agreed that if schools and hospitals were privatised, this may deprive people of their services. This may indicate, beside inconsistency, confusion and above all confirms that the business community is not well informed about privatisation plans and that the matter should not be left to their desires or speculation but subjected to a careful assessment and study.

However, the main reason given in justification of this opinion is that the privatisation of such services may deny people access to such services. In many countries, the privatisation of such services, because of their social-value, is always the last. And when it takes place in such a domain, it is restricted to contracting out some of their activities such as cleaning or maintenance. By their nature, education and health are welfare services for the people and society at large. This is why they have to be examined and considered differently. However, within this domain, as pointed out, there are some activities which can be privatised e.g. school bus services. This is sometimes very useful because it deters people from using or abusing services and rations resources.

THE TIMING OF PRIVATISATION

The introduction of privatisation at the appropriate time is very important for its success. In the British experience of privatisation there was no definitive
piece of legislation, and the concept was not even contained in the Conservative party manifesto for the 1979 election when the Tories came to office. It was not an issue in the 1983 election either. But in June 1987 the Conservative government of Mrs. Margaret Thatcher was returned to power on a platform of radical change. This has ensured the continued progress of privatisation in Britain. If, on the other hand, privatisation had been introduced in Jordan earlier, it may not have been an issue of priority. But when relations with the Arab Gulf states deteriorated and many Jordanian workers returned as a result of the Gulf War, privatisation became predominant. Is it then time for privatisation in Saudi Arabia?

The question naturally brings to the discussion many considerations, either regarding the role and efficiency of the private sector, the legislative structure, the trade policy, the financial position of the government, the managerial and technical skills, or the banking system and financial market.

In answering the question, enough evidence was presented in the Fifth Development Plan that shows that the government is now politically motivated towards privatisation, to achieve economic efficiency, and reduce the burden to the government of heavy subsidies as well as gradually creating a free-market economy. Furthermore, the private sector has now both the technical skills and finance to contribute to the achievement of such objectives. The private sector is projected to increase its share of value added during the Fifth Plan period (1990-1995) in real terms by 0.3 percent in the producing/services sectors, about three percent in the non oil GDP and about two percent in total GDP through privatisation initiatives. The private sector will be the locus of employment opportunities during the period and future.
The expectation is that over 95% of employment growth during the plan will take place in the private sector.

The question of timing was addressed in the “survey”. Ninety four percent of all answers support privatisation as figure (6.7) shows. This support, at this particular time, can be attributed to a variety of reasons. These include:

- The private sector in Saudi Arabia is developing rapidly.
- The international experience is very encouraging and shows promising results that can be gained similarly in Saudi Arabia.
- The public sector is over extended and the economy needs the effective participation of the private sector.
- Privatisation will lead to an expansion of services particularly in such a country like Saudi Arabia given its geographical and regional structure.

Figure (6.7)

TIMING OF PRIVATISATION
This result is consistent with their view as 77% of the respondents agreed that privatisation should not have been introduced earlier and 94% were of the opinion that it should not be delayed.

In a country like Saudi Arabia where the control over revenue is in the hands of the government, many enterprises naturally have to be initially state-owned because the state has the appropriate finance to buy and create them. The situation is changing now in view of the growing burden of the deficit to the state and the development of the private sector. These factors, as they stand, are indicators that the time to privatise may be now.
Chapter Seven

Barriers

To Privatisation In Saudi Arabia
In almost all developing countries there are major obstacles to privatisation. These include weakness of capital markets, inefficient political decision-making processes and bureaucracy, lack of skilled manpower and inadequate information. The lessons of the international experience showed, particularly, that government interference and large involvement across all sectors are probably the greatest deterrent to privatisation in these countries. Saudi Arabia, by comparison, is not much different.

The issue of constraints to privatisation has been investigated in two parallel ways. First by examining the usual problems of economic development in Saudi Arabia and associating them to privatisation to determine to what extent they also can effect the process of privatisation. Secondly, through the survey, in which the views of the respondents about constraints to privatisation were collected. The following discussion will attempt to present a full account of both investigations.

In Saudi Arabia, major constraints to economic development have been identified in development plans. These constraints include: a) heavy dependency on oil as the only source of income, b) inadequate infrastructural base, c) severe shortage of skilled manpower; and d) under-developed private sector.

Over the years, some of these problems have already been eliminated. However, problems of manpower, inadequacy of information, subsidies, and reliance on the public sector will be re-examined to determine their impact on achieving privatisation.
An over extended role of public sector:

In the initial stages of development, especially during the first and second national development plans, there was, evidently, a belief that private initiative would not be sufficient to develop the industrial and infrastructural base. And indeed the private sector did not have either the resources nor technical capabilities for the necessary modernisation.

"The trends in the economy showed that the main determining factor in the pattern of output and private sector growth was the concentration by the government on the development of infrastructure and other logistical priorities." (1)

This resulted in the creation of an over extended public sector, and a system that seemed permanent and expansionary even though the private sector's capabilities developed. What might have been an appropriate catalytic public sector role in the early stages of development turned into a long-term arrangement which then hampered the evolution of the private sector. The implications of such involvement have two aspects. First, it may make some public enterprises unattractive for potential private investors due to the associated inefficiency of state administration which would require a complete restructuring. Secondly, the expansion of the public sector may lead to another future problem. The transformation of huge operations would require a lot of time to allow for their absorption into the private sector which may delay the scale of privatisation in Saudi Arabia for a considerable time. This may mean that a gradually introduced privatisation programme is preferable,

if not essential. Moreover, to confirm some of these findings about the size and efficiency of the public sector in Saudi Arabia, some questions were put into the survey in order to assess the opinions of businessmen with regard to this matter. The respondents have reacted decisively to this matter. The survey showed 64% were of the view that the public sector in Saudi Arabia is over extended, similarly 68% of the respondents were of the view that the role of the public sector in economic activities should be reduced.

Although such opinions may be accepted theoretically on the basis of administrative inefficiency, before decisions are made, the public sector issue needs careful assessment regarding its economic performance. The public sector occupies special importance in the Saudi Arabian economy as the key element of development.

"Since the development process begins with the conversion of oil revenues into domestic assets, and given that each stage of this process is administered by the government, economic development is, to a very large extent, a government activity."(1)

This confirms, directly or indirectly, that the transfer from the public to the private sector should be made for more legitimate reasons other than mere size or control.

HEAVILY SUBSIDISED PRIVATE SECTOR:

The private sector was supported by the government especially at the early stages of planned national development i.e. 1970 onwards. This support was

---

essential in order to develop the private sector capabilities. The generosity of the Saudi Arabian government led to a grant of SR 142.23 billion in loans and subsidies in the seven year period between July 1975 and April 1982 to help the private sector assume its proper role in the economy. During the same period (as an example) the government subsidies for food products (rice, sugar, flour, barley, corn, meat, oil and milk) amounted to SR 11.36 billion. Subsidies for those products were determined on the basis of the cost to the importer plus a 10% profit. The government paid the difference between this figure and the official market price. Similarly subsidies for electricity consumption for the same period amounted to SR 6.56 billion. As the government has set electricity consumption charges at SR 0.07 per kilowatt hour for households and commercial use and SR 0.05 for industrial use, it funds the difference between these prices and the actual cost including shareholders' profits.

Specialised credit institutions, which channel government funds to specific sectors of the economy in the form of interest-free medium and long-term loans, had an enormous impact on the development of private business.

"Since its inception and up to the end of the fiscal year 1992/93, the Saudi Industrial Fund has sanctioned a total of 1,532 loans for establishing 1,249 industrial projects in the various parts of the Kingdom. Commitments to these projects totalled SR 21,722 million ($5,792 million) of which SR15,117 million ($4,031 million) has been disbursed."(1)

---

As a result of such support, industrialisation in Saudi Arabia has been progressing at a very rapid pace. The point of argument here is that although this support is generally a good thing, it should not be taken to the extreme.

This support resulted in extensive reliance on the public sector while the private sector could have explored other avenues for finance and development. In the first stages of Saudi industrialisation, when projects originally got off the ground, commercial bank borrowing represented only about ten percent of capital investment.

In the Fourth Development Plan the government emphasised the "Rationalisation of Subsidies" in order to get out of the bottleneck of further commitments that were offered to the private sector for so many years. Therefore, cash advances to contractors have been cut and tighter monitoring of their work imposed; compulsory public tendering for government contracts has been introduced; subsidies have been reduced and public sector allowances and benefits have been curtailed.

However, certain financial developments offset the decline in government outlay and consequently benefited the private sector. Among these, was a significant inflow of the private sector's own capital, representing a partial repatriation of funds invested abroad during the boom years. Secondly was an effective use of cash balances by the private sector possibly due to the growth of commercial bank branches which may have stimulated a more productive use of savings that had previously been laying dormant.

During the Fifth Plan-period 1990-1995 the Kingdom's subsidy policy will be reviewed further on the basis of issues which are even more relevant to the
content and objectives of privatisation. The rationalisation of subsidies was necessary for the following reasons, the plan suggests:

1. A number of subsidies, such as those for real estate development, have outlived their usefulness as the housing shortages have been virtually eliminated.

2. Subsidies are used only insofar as they affect the relative price structure of the market. As they become prevalent in many fields their effectiveness declines.

3. The essence of a market economy is the free interplay of market forces. Thus, it has become evident that the extensive subsidy system in the Saudi economy, despite having effectively achieved its immediate objectives, has also caused various forms of market distortion. For example, wheat subsidies may have attracted resources away from other field crops.

4. Price subsidies induced excessive consumption and cause wasteful utilisation.

The Plan strategy, therefore, will focus on reducing subsidy rates without significantly affecting low income consumers.

**Manpower Shortages**

Lack of skilled and professional manpower is one of the chronic problems facing development in Saudi Arabia. This shortage was both in quantity and quality. Despite full government support and commitment to a Saudiization
programme, targets such as those of the Fourth Development Plan which aimed at lowering the non-national employment level by 600,000 and increasing Saudi employment by 375,000 between 1985-1990 was not achieved. This was mainly due to wage differentials between Saudis and non-Saudis, the restriction of female employment to certain job categories and reliance by the private sector mainly on the employment of expatriates for a variety of reasons - among which was the lack of market information on the quality of new Saudi entrants to the work-force.

Saudi workers have been criticised for being under-productive. This image is currently changing with the expansion and modernisation of the educational and hiring system. For many years the educational system exhibited some weaknesses. First, the structure of education enforced the notion in school children that a university education is the summit of school activity. This puts a value on those courses which lead to university and a low premium on non-university options such as technical education. Second, the teaching methods and curricula were inflexible and repetitive.

The dilemma is that the type of work usually required to enforce a successful privatisation programme is immense and complicated and calls for special skills and manpower qualities. It includes setting up records, restructuring of enterprises, deregulation, valuation of assets, development of investment procedures, basic share valuation modelling, equity finance and costing. Apparently, despite Saudi Arabia's achievements in human resource development, the technical skill to carry out such tasks may not be available.
The UK experience shows that even in a sophisticated financial environment where shares are routinely traded in large volumes, and high quality advice can be readily obtained, it is difficult to establish the market value of an enterprise before selling it. Valuation problems would be compounded in Saudi Arabia in view of the absence of an adequate stock market, a centre for information, and appropriate human skills. Such problems should be carefully assessed and resolved prior to embarking on privatisation.

At the present, linkages between higher educational institutions and the private sector are inadequate to serve the development needs of the economy.\(^1\) The level and quantity of commercial education needs to be developed further. The relationship between universities, in particular, as centers for research and consultancy, and the private sector needs to be established. But above all, the private sector itself should be steadily encouraged to provide efficient training and education in a variety of disciplines.

**Inadequate Information:**

Reliable information plays a key role in reducing uncertainties. It is an important tool for sound investment decisions. The importance of this matter places it at the top of government priorities in support of the private sector through a programme of wider dissemination of business information during the Fifth Plan period.

\(^1\) - Ministry of Planning-. Fifth Development Plan 1990 - 1995, p. 263
The implementation of a privatisation programme in Saudi Arabia will depend, to a large extent, on the quality of business services which are provided. In this respect the Fifth Plan urges the need to establish specialised non-profit associations that provide professional services to their membership, and act as centres for specialised information on industrial and professional issues.

The problem in Saudi Arabia is that, generally, information is not available and even when it is, it is difficult to obtain. From the "survey", it appears, that 83% responded with the view that neither the private sector nor the public in general are well informed about any future privatisation plans. This may indicate centralized control of information in the hands of the government and a general weakness of the information structure and procedure as a whole in the Kingdom.

In their survey about Saudi Arabian industrial investment Wahib Soufi and Richard Mayer found that:

"Thirty-seven of the fifty managers (74%) saw the government-provided information as inadequate for their purpose... And when the business sample was asked whether the reliability of the government-provided information was a problem, two thirds answered critically." (1)

Adequate information is a basic requirement for a free market economy. However, in many developing countries, and Saudi Arabia is no exception, information which is readily available in the developed world may be closely guarded for social, political or economic reasons. There is no tradition of

---

1 - W.A. Soufi and R.T. Mayer: Saudi Arabian Industrial Investment, Quorum Books, USA, 1991, p. 52
freedom of information. Societies tend to be conservative and value privacy. Information is on a "need to know basis".

When it comes to privatisation, this presents several problems for investors. Naturally enough, governments would like to show the performance of the public sector in the best possible light. Simply because the public sector is under direct government control, some investors may be a little wary of past performance figures and the inability to verify them. It is only in the recent past that the world community has accused the Saudi public sector of "dumping". For example, Saudi Arabia won a contract to supply wheat to New Zealand at the expense of the traditional supplier, Australia. The Saudi steel manufacturer, Hadeed, has supplied steel re-enforcement to Japan at the expense of Asian competitors. On both occasions, dumping was claimed. The dumping issue is only relevant here in that a potential investor wants to know about the profitability of proposed privatisation projects and may suspect "creative accounting".

However, by all accounts, Hadeed is a very profitable company, but this again illustrates another aspect of lack of information - this time about future government intervention, and this is critical.

The next phase of development for Hadeed is up for tender. Apparently, there is no lack of interest to construct and run the operation, but the tender bids depend on government intentions. Again, this is only rumour, but it is said that one foreign company has offered to build the plant for free as long as it can operate as a joint venture under existing market conditions for the next twenty years, i.e. under monopoly conditions in the Saudi market. This illustrates the
point that the private sector has no idea what privatisation will bring. Will the
government go for the transfer of monopolies from state ownership to private,
or go for a free market, which is a totally different prospect for the investor.

At the same time, by the nature of the fact developing countries are in some
ways under-developed, collection of information may not have taken place
through lack of infrastructure, will, need, or experience. For example, there is
no daily newspaper equivalent to the Financial Times or Wall Street Journal
in Saudi Arabia. However, any member of the general public can pick up the
telephone, ring a bank, and immediately get the exchange rate of the Saudi
Riyal against almost all traded currencies - because there is an everyday need
for this information.

The above seems to illustrate that there is a lack of general information for the
investor, but that information of a non-sensitive nature would be readily made
available if the market were strong enough. The difficulty seems to be
obtaining accurate information from government.

**Attitudes of public officials**

The resistance to privatisation by public officials is one of the common
problems in almost all countries, and even the reasons behind this resistance
is typical. The survey confirmed such belief. When the respondents were
asked whether they think that senior officials in the public sector are major
obstacles to privatisation, 43% indicated their agreement. This, as expressed
in their justification, is mainly due to the concern of the public officials over
loss of their jobs and status.
But the matter in Saudi Arabia is more complicated than that as the issue is more associated to political sensitivity rather than economic feasibility or job security. The political structure of Saudi Arabia is very centralized, as outlined in chapter two, which created excessive control over services and facilities. Some of these facilities, such as the airline or telecommunications, are seen as important factors in maintaining the political unity of a desert Kingdom of nine times the size of UK and therefore handing some amenities to private hands would require special considerations. Thus the resolving of such constraints will depend on factors such as changes of attitudes, liberalisation, and policy reform.
Chapter Eight

ECONOMIC AND SOCIAL IMPlications OF PRIVATISATION IN SAUDI ARABIA
Saudi Arabia is a country where economic and social developments come hand in hand.

"The distinguishing mark of the Saudi approach to development is that its material and social objectives are derived from the ethical principles of Islam and the cultural values of Saudi society. These principles and values are reflected in the importance attached to both the social well-being and personal fulfillment of all citizens, and to the creation of a wide range of institutions and services freely provided for these purposes, and the support of free enterprise, subject to the interest of the community at large."(1)

This concept is based on Islamic values and understanding which give the same degree of importance to both society and individuals.

"By asserting and invoking Islamic concepts about society, a unique blend of material and social advance has been achieved. While using the same institutional forces as exist in other societies (government and the market economy), the requirements for individual initiatives and for social responsibility have been kept in a morally acceptable and creative balance."(2)

In fact, the success of Saudi development has also been made as a result of avoiding substantial gaps between various economic sectors, regions, or individuals in society. There is no escape from value choices in welfare systems. The construction of any models or the elaboration of any theories which have anything to do with "policy" must inevitably be concerned with what is and what might be, with what we as members of society want and with how we get there.(3)

---

3 - Richard M. Titmuss: Social policy, George Allen and Unwin, 1979, p. 132
In Saudi society businesses are often “family business”, and extended family or tribal ties are still strong. So Saudi businessmen, although as keen to maximise profits as any investor, would also be wary of any adverse social implications of privatisation. This awareness of the social and economic implications is reflected in some of the survey results.

According to the respondents, privatisation will

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>increase economic efficiency</td>
<td>74%</td>
<td>cause unemployment</td>
<td>38%</td>
</tr>
<tr>
<td>improve quality of services</td>
<td>77%</td>
<td>deprive people of services e.g.</td>
<td>64%</td>
</tr>
<tr>
<td>help towards a free market economy</td>
<td>96%</td>
<td>create social problems</td>
<td>47%</td>
</tr>
<tr>
<td>increase government revenues</td>
<td>49%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>redistribute wealth</td>
<td>74%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>help technology transfer</td>
<td>94%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This is reinforced by the fact that 91% of respondents thought that the benefits of privatisation were not only economic, that 77% thought the government should retain some shares in privatised companies to exercise some control, and that 79% thought that oil, as the main source of income, and mineral wealth should stay in government hands.

This chapter attempts to identify the main social and economic implications of privatisation for Saudi Arabia as the government endeavours to maximise social and economic benefits and minimise economic and social disadvantages. The first point to which we have to direct our discussion is the
“economic implications” in Saudi Arabia. What are they and how can they come about?

1. Maximisation of Revenues (for the government)

One of the main aims of privatisation at the present time is to raise revenue to help reduce the budget deficit. In Saudi Arabia opposite developments to the years of economic boom and prosperity have taken place. The erosion of oil prices throughout the 1980’s, especially the collapse of 1985/86, has led to a severe shrinkage of the government’s spending power. The Kingdom’s involvement in the Kuwaiti crisis added further to financial deficit as the Kingdom spent more than it earned by drawing on its reserves to finance much of the allies’ campaign to liberate Kuwait. The economic impact of this crisis can be seen in the expansionary spending policy on the military that took place immediately after.

"Military spendings remains enormous. Almost half of the projected increase in the 1993 budget has gone to defence sector. This now accounts for no less than 31.3% of total government spending". (1)

This expenditure has also come at a time of a long run downward trend in oil revenues. While the government can immediately raise revenue by privatisation sell-offs, there is potential danger in this policy. If oil prices remain on their downward trend, the government faces long term falling revenues in this sector - its main source of income. At the same time, selling off the public sector will reduce a potential future stream of income for the government. Therefore, this suggests that privatisation revenue should, at least

in part, be used for investment by the government and not merely to reduce the deficit. The other implication is that the government may have to look at other sources of revenue to finance its expenditure.

At first glance, it may be thought that revenue raising through privatisation would be straightforward - simply getting the best price for what is privatised. A closer examination reveals that this is not quite as easy as it sounds. Determining the market price of a public enterprise in advance of a sale is difficult since there is very little information on which to base an estimate. Selling by tender would, therefore, seem to be logical, especially where the enterprise has no private sector comparator. However, this has been regarded as too complex a method of sale to secure the participation of small investors. Another potential problem is that if sale is by tender, the reserve price may not be reached.

Offers for sale at a fixed price also have potential hazards. Either the issue could be over-priced due to an ill-judged estimate, or market conditions could change during the interim between revealing the offer price and the actual closing date for purchase. A more likely scenario would probably be that the offer price would be too low (either by an under-estimate or by design to buy favour for the government). Consequently, shares come to the market at a discount, which diminishes the potential return to the government coffers.

Although it is possible to combine tender and fixed price methods, it is likely that the Saudi government would opt for the most simple method - the fixed price offer for sale. Expert advice would no doubt be taken as to price and timing of sale, but what to privatise at any particular time to give maximum

---

Table (8.1) 

The Percentage of Government Participation in 
Selected Publicly Traded Companies

<table>
<thead>
<tr>
<th>Companies</th>
<th>Government %</th>
<th>Paid-up Capital (SR Million)</th>
<th>Government Paid-up Capital SR million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Riyadh Bank</td>
<td>29%</td>
<td>2000</td>
<td>580</td>
</tr>
<tr>
<td>Saudi Bank for Investment</td>
<td>8%</td>
<td>90</td>
<td>7.2</td>
</tr>
<tr>
<td>Saudi Cairo Bank</td>
<td>25%</td>
<td>1200</td>
<td>300</td>
</tr>
<tr>
<td>Saudi American Bank</td>
<td>10%</td>
<td>1200</td>
<td>300</td>
</tr>
<tr>
<td>Saudi Fisheries Co.</td>
<td>40%</td>
<td>100</td>
<td>40</td>
</tr>
<tr>
<td>NADEC</td>
<td>20%</td>
<td>400</td>
<td>80</td>
</tr>
<tr>
<td>Tabouk Agricultural Co.</td>
<td>8.17%</td>
<td>200</td>
<td>16.3</td>
</tr>
<tr>
<td>Al-Jouf Agricultural Co.</td>
<td>1.50%</td>
<td>200</td>
<td>3</td>
</tr>
<tr>
<td>Saudi Cement Co.</td>
<td>0.78%</td>
<td>2040</td>
<td>159.1</td>
</tr>
<tr>
<td>Al-Yarmamah Cement Co.</td>
<td>1%</td>
<td>900</td>
<td>90</td>
</tr>
<tr>
<td>Al-Qasim Cement Co.</td>
<td>37%</td>
<td>300</td>
<td>111</td>
</tr>
<tr>
<td>Yanbu Cement Co.</td>
<td>12%</td>
<td>700</td>
<td>84</td>
</tr>
<tr>
<td>Southern Cement Co.</td>
<td>40%</td>
<td>700</td>
<td>280</td>
</tr>
<tr>
<td>Eastern Cement Co.</td>
<td>30%</td>
<td>907.5</td>
<td>290.25</td>
</tr>
<tr>
<td>Saudi Ceramic Co.</td>
<td>22%</td>
<td>150</td>
<td>33</td>
</tr>
<tr>
<td>Gas &amp; Manufacturing Co.</td>
<td>15.50%</td>
<td>500</td>
<td>77</td>
</tr>
<tr>
<td>Petromin Lubrication</td>
<td>71%</td>
<td>15.5</td>
<td>11</td>
</tr>
<tr>
<td>Arabian Drilling</td>
<td>51%</td>
<td>20</td>
<td>10.2</td>
</tr>
<tr>
<td>Jeddah Refinery Co.</td>
<td>75%</td>
<td>150</td>
<td>112.5</td>
</tr>
<tr>
<td>SAFCO</td>
<td>41%</td>
<td>200</td>
<td>82</td>
</tr>
<tr>
<td>SABIC</td>
<td>70%</td>
<td>10000</td>
<td>7000</td>
</tr>
<tr>
<td>SAFOLA</td>
<td>7.44%</td>
<td>300</td>
<td>22.3</td>
</tr>
<tr>
<td>AR AR Electricity Co.</td>
<td>59.85%</td>
<td>15</td>
<td>8.85</td>
</tr>
<tr>
<td>Tabouk Electricity Co.</td>
<td>33.3%</td>
<td>8</td>
<td>2.6</td>
</tr>
<tr>
<td>Domat Al-Jandal &amp; Al-Jouf Electricity Co.</td>
<td>80%</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Rafha Electricity Co.</td>
<td>54.85%</td>
<td>4</td>
<td>2.1</td>
</tr>
<tr>
<td>Eastern Electricity Co. (SCECO-East)</td>
<td>49%</td>
<td>5000</td>
<td>2450</td>
</tr>
<tr>
<td>Central Electricity Co.</td>
<td>77%</td>
<td>8000</td>
<td>6160</td>
</tr>
<tr>
<td>Western Electricity Co. (SCECO-West)</td>
<td>84%</td>
<td>8000</td>
<td>6720</td>
</tr>
<tr>
<td>Southern Electricity Co. (SCECO-South)</td>
<td>98.70%</td>
<td>4000</td>
<td>3940</td>
</tr>
<tr>
<td>Saudi Hotels Company</td>
<td>39%</td>
<td>500</td>
<td>159</td>
</tr>
<tr>
<td>Real Estate Co.</td>
<td>73%</td>
<td>600</td>
<td>438</td>
</tr>
<tr>
<td>Saudi Transportation Co.</td>
<td>30%</td>
<td>1000</td>
<td>300</td>
</tr>
<tr>
<td>Sea Transportation Co.</td>
<td>28.90%</td>
<td>2000</td>
<td>578</td>
</tr>
<tr>
<td>Co-operative Insurance</td>
<td>100%</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Taiba for Investment &amp; Development</td>
<td>11%</td>
<td>3000</td>
<td>330</td>
</tr>
<tr>
<td>Mecca For Construction</td>
<td>6.89%</td>
<td>1355</td>
<td>93.3</td>
</tr>
</tbody>
</table>

Source: Asharq Al-Awsat Newspaper No. 5642 Tuesday, 10/05/1994
return to the government is as much a political decision as an economic one, as the government would try to minimise the side-effects of privatisation. However, it would seem reasonable to raise revenue by selling holdings in the areas where government support is very small or where the private sector is already very strong, for example, banking, insurance, hotels (see table 8.1), and side-effects of revenue raising could be considered non-existent. Larger more controversial privatisations could wait until later. As people became more educated about share holding, the government could increase its privatisation programme.

2. Further Reduction of Subsidies

For a government trying to reduce its budget deficit, a reduction in subsidies is an obvious attraction of privatisation. In Saudi Arabia, government subsidies have played an important role in the development of the major producing sectors such as industry and agriculture. Especially in the case of the latter, there has been a drain on government finance through excessive subsidies available for a wide range of agricultural inputs and machinery. The net result of such imbalances is budgetary deficits and growing debts. Different development plans call for “Rationalisation of Subsidies” and serious steps are taking place in that direction. Now, as Saudi Arabia embarks on privatisation, the removal of more subsidies is expected to be intensified.

Reduction in subsidies will help to reduce the budget deficit but, OTRE, this could lead to a reduction in supply (S-S₁) and possible price increases (P-P₁), as in diagram 7.
Obviously, this has implications for the efficiency and competitiveness of Saudi industry and has potential social implications - which will be discussed later.

3. Efficiency Improvements

One of the benefits expected by Saudi businessmen, as indicated in the survey, is an increase in efficiency (74% of respondents). According to Hemming and Mansoor, "privatisation is seen primarily as a means of improving the efficiency of enterprises. Because it is believed to limit the scope for political interference in decision making, to increase managerial incentives by making managers responsible to share holders who will monitor their performance better than governments and to impose the financial..."
discipline of private capital markets (including the market for corporate control), there is likely to be an incentive to seek productive efficiency, and fewer barriers to attaining it.”(1)

In the case of privatisation leading to a perfectly competitive market, both allocative and productive efficiency can be expected as illustrated in diagram - 8 -.

**Diagram - 8 -**

*Allocative and Productive Efficiencies in a Perfectly Competitive Market*

There is productive efficiency as production is at its optimum point, the lowest point on the ATC curve. Allocative efficiency is achieved because the price the consumer is willing to pay is equal to the cost of production. Under the Saudi system of subsidies, the market is distorted and inefficient. The system encourages goods and services to be sold at prices below the real cost.

---

of production. Therefore, as illustrated in diagram - 9, there is a mis-allocation of resources with $Q_1$ demanded at the lower price $P_1$, instead of $Q$ at price $P$. Price becomes less than marginal cost, therefore allocation is inefficient. However, it is not suggested that privatisation will lead to perfect competition in the short run. If it is achieved at all, it must be a long run objective.

Diagram - 9

Demand, Supply, Price and Subsidies

In the case of the steel producing monopoly, "Hadeed", there is no suggestion at this stage that privatisation would be anything but a straight transfer of a public monopoly to the private sector. Hadeed has a monopoly in the Saudi market for steel. It enjoys considerable scale economies which could be lost if the private market were competitive. Therefore, some would argue that moves leading to allocative efficiency could lead to undesirable losses of cost efficiency. If the government wishes to introduce allocative efficiency into its
public monopolies, it could use marginal cost pricing policies. This achieves allocative efficiency (the cost of an extra unit of output equals the consumers’ willingness to pay for it) and productive efficiency (there are economies of scale and no duplication of fixed costs due to competing firms). Losses could be covered by government subsidies. However, in a privatised deregulated market, such a firm would become a profit maximising monopoly.

4. The Expansion of the Tax Base

In Saudi Arabia, there is no personal income tax. The main taxes are corporation tax (on foreign companies) and Zakkat (an Islamic tax aimed at redistributing income from rich to poor). There are various levies and import duties, but in general, taxation is light by any standards.

"The combination of a weak tax system and heavy subsidies led to underestimating the cost of living, a situation that may still be causing a misallocation of scarce resources in current business sector planning" (1)

The strong oil revenues of the seventies and eighties have meant that the tax system has been neglected. However, one of the outcomes of privatisation may be an increase in both direct and indirect taxation. If the government is faced with falling oil revenues, possible unemployment and social security programmes to finance, and no further stream of income from public corporations, then increased taxation looks a distinct possibility.

5. Market Forms and the Creation of a Market Economy

It is often thought that privatisation leads to a free market economy. Indeed, 96% of businessmen, in the survey, thought that privatisation will help

towards a free market economy. This may be a long term aim but it is certainly not inevitable. The public sector of the Saudi Arabian economy consists of various market forms and privatisation would affect each one differently. The market form would also influence the decision as to whether to fully privatise or not.

Industries which are natural monopolies would probably be the last candidates for full privatisation. These are industries where the costs involved mean that competition would lead to wasteful duplication. For example, water supply in Saudi Arabia by desalination involves huge capital expenditure on plant and distribution. It is unlikely that any private investor would buy the whole package at an economic price because the returns would probably mean that a profit could never be made.

Diagram - 10 -
Loss Making Natural Monopoly
In fact, many of the public sector monopolies are services to the Saudi market e.g. water and electricity, and may be in the position shown in diagram 10.

Sweet water is a symbol of the country’s success and is so plentiful that it is almost regarded as free. The cost to both domestic and industrial consumers is negligible because of subsidies. This has led to the waste of this valuable resource by over-use.

In such a situation, where a sell-off is unlikely, contracting out of some aspects of the operation (e.g. maintenance) is a possible alternative. Another possible alternative would be a form of franchising. Henry T. Azzam points to a scheme for new projects which does not operate in the Kingdom as yet, but which has an attraction for a government facing tight budgetary conditions. These schemes are the Build Operate and Transfer Schemes.

“*The BOT model allows the private sector to finance and execute a certain project and then operate it for a concession period during which the revenues earned would cover initial investment and a certain rate of return. At the end of the concession period, the project is transferred from the private operators to the host government*”(1)

Other state monopolies in the industrial sector will likewise keep their monopoly status for the foreseeable future after privatisation. The case for a perfectly competitive free market economy as opposed to monopoly is summarised in diagram - 11, but for Saudi Arabia, the advantages of a free market economy - for social, economic, and political reasons, - may not be so great at this stage of the country’s development.

---

Diagram - 11 -
Perfect Competition v Monopoly

Perfect Competition

1. Allocative and productive efficiency
2. Normal profits
3. Free movement of factors of production
   - Unlimited resources
4. Perfect knowledge
5. Price taker
6. Free entry / exit to market
7. Innovation and choice

Monopolisation of the Perfectly Competitive Market (OTRE)

- Higher price and lower Q produced
- Super normal profits
- Barriers to entry
- Less choice and innovation
- Inefficient
- Price or quantity fixer

The situation, even in theory, is not so clear. It assumes that a monopolist has the same costs as the perfectly competitive industry, which may not be realistic. If the monopoly benefited from economies of scale, then it could have a cost advantage (MC3) leading to an increased output Q3 and lower price P3 than under perfect competition.
These economies of scale and super normal profits may lead to finance for research and development which would not be available under competition. This could give advances in technology, product development, and more choice. Because of this market strength, the monopoly can also maintain employment and production when a competitive firm had gone out of business. This is especially the case with some of the Saudi companies, because although they may appear to be monopolies in Saudi Arabia, in fact they are in a competitive market on a world scale, and many operations are already contracted out within the monopoly. This is especially true of Saudi heavy industries, e.g. petrochemicals, agrochemicals, and iron and steel. They have no competition at home but can be seen as having a small number of large competitors worldwide.

Diagram - 12 -
International Market Position of Saudi Heavy Industry
It can be argued that the strong home market position enables them to compete abroad and that profits are normal (see diagram - 12) in the worldwide market and that the market position should be maintained.

Employment is an important factor. A competitive firm is likely to shed workers after privatisation to maximise profits. A Saudi state monopoly can take into account the profit or social benefit from employing seemingly unproductive workers. The gains in efficiency through the privatisation process may be offset by resources being made redundant (i.e. manpower) that the private firm would not necessarily consider. The cost of unemployment is discussed later. The crux of the matter seems to be whether the efficiency gains enforced by privatisation outweigh the social costs. In the long run the answer is probably ‘yes’, and in the short run it is probably ‘no’.

6. Development of the Financial System

The effects of privatisation on the financial system are likely to be enormous in the long run. As mentioned earlier, Saudi Arabia has no stock market institution as such and only a limited number of companies’ shares are actually traded. For a privatisation programme on the scale of that envisaged in Saudi Arabia, it is likely that an efficient equity market will be developed in the near future to supersede the present system through the commercial banks.

The operations of the commercial banks are likely to change to meet new business. As the government withdraws as a source of finance, the commercial banks will be asked to fulfill this role. Commercial bank lending has traditionally been short term, but in future, it is expected that private companies will be looking for long term financing.
With privatisation, it is also expected that the small private investor will become more aware of savings and investment opportunities. These will have to be further developed by the commercial banks. As for the development of the insurance sector, this is unclear. Insurance, as such, is not in keeping with traditional Islamic thought, therefore this will probably be a restraint on the further development of this area.

7. Redistribution of Wealth

The effect of privatisation on the distribution of wealth in Saudi Arabia is a matter of speculation at this stage. Seventy-four percent of respondents in the survey expected privatisation to help in wealth redistribution. From an Islamic point of view, the owning of shares (as opposed to interest bearing deposits) is an acceptable form of investment, therefore, privatisation sell-offs could be well supported. However, Saudi Arabia is like many other countries in that people in general are not familiar with share holding, public floatations, stock markets and the like. Therefore, initially at least, any financial gain from share holding would tend to go to the more educated investor who has spare funds to invest. The other kind of beneficiary would be the investor who is an employee of a privatised public enterprise and is offered shares - possibly free, at a discounted price, or on a preferential allocation basis. The latter would increase share ownership and possibly help redistribution of wealth.

What is certain is that although the Saudi public may be unsophisticated in financial matters, they will soon become aware of any profit that could be made form privatisations. Therefore, it is expected that the general public will become more and more involved in the privatisation process as the momentum grows.
However, there is a note of caution. The employees receiving shares through privatisation of their firm may be the same ones who later find themselves redundant as the drive for efficiency and profit takes hold. In such a case, the redistribution of wealth could be negated. Also, if shares are offered at a price which is too low, when the shares come to the market small investors will be tempted to sell quickly for a quick profit. This was the case with many privatisations in Britain and there must be the temptation for the Saudi government to make privatisation shares equally attractive to Saudi investors. At a later stage, the British government tried to sell the long term benefits of share holding as opposed to short term gain. This was encouraged by loyalty bonuses, which could also be incorporated into the Saudi process.

8. Macro-economic implications

The effect of privatisation on the Saudi Arabian balance of payments may be negligible or considerable. In theory, the change of ownership of assets from public to private sector should have no effect. However, if there are gains in efficiency then Saudi exports may become more attractive to foreign buyers through price and quality. Also, imports may be reduced as the private sector responds to the needs of the home market and substitution of home produced goods for imports takes place. Such a scenario would tend to strengthen the Saudi riyal.

As far as privatisation proceeds are concerned, the revenue may help solve the immediate problem of the budget deficit, but the government forgoes any future income stream from the privatised enterprise. This may lead to future borrowing or the raising of taxation, as already mentioned.
The Social Implications

In every society the “Government” has special economic and social roles to play. And out of this function stem a number of responsibilities. If as a result of recession, for example, and a situation of financial difficulties, the government decided to give up some of its economic responsibilities, that can be accepted or at least understood in the hope that several benefits may be gained from the private sector’s take-over of the operations of certain public enterprises. These include an immediate benefit in the form of subsidy reduction which implies that public funds “liberated” can be used more productively elsewhere in the economy. This may generate additional employment, reduce the current budget deficit, and raise domestic savings as well as public investment (1) But when it comes to giving up the “social responsibilities” of the state for economic returns, it can not be justified, as services to society such as “schooling, health, defence, and even the provision of water, gas and electricity have broader social objectives which lie behind their function. These services are provided by society to ensure the welfare of disadvantaged and minority groups.

What appears to be frightening is the extraordinary attitudinal naivety of those who argue only in such terms as “efficiency” and “effectiveness” regardless of any considerations of values, equity or the wider interest of society.

In Saudi Arabia, the government, in many ways, is seen as paternalistic and many public sector monopolies are services to the Saudi market e.g. electricity and water and it is unlikely that these benefits would be withdrawn quickly. This would mean a massive income support programme to the majority of the low/middle-income families after privatisation.

There are other social implications for privatisation in Saudi Arabia. These will be discussed as follows:

1. Unemployment

One of the social effects of privatisation tends to be unemployment as the newly privatised firms aim for profit maximisation and productive efficiency. While this may be an essential long term aim for the Saudi Arabia to release resources for more productive use, there are important interim implications which should be considered.

It is argued that unemployment caused by privatisation will fall mainly on the expatriate sector, as earlier suggested. This seems logical but, it also seems to be flawed in various ways. Firstly, not enough Saudis have the skills to fully replace their expatriate counterparts. Secondly, many do not have the will to do jobs done by expatriates - especially “menial” tasks. Thirdly, a private employer may actually wish to employ an expatriate instead of a Saudi because he sees the expatriate as more productive and may accept a salary which would be less, in some circumstances, than that he could offer to a Saudi. Therefore, unemployment could be a real problem.

As already mentioned, the Saudi Arabian government is seen as paternalistic. Many advantages are provided to public sector employees (e.g. loans, subsidised housing, healthcare etc.). In the survey, 47% of the respondents believed that privatisation could cause social problems, therefore it is unlikely that these benefits would be withdrawn quickly. This would mean a massive income support programme to maintain the living standards of the unemployed. Maybe it would be better to keep people in public employment, gaining experience of modern technology and work methods, as privatisation
revenues could be offset by social security payments because there is no immediate alternative use for this resource.

Secondly, Saudi manpower is in a learning process - not only about a specific job but about work in the industrialised/ commercial world in general. The experience of one generation is passed to the next (as has been done from the industrial revolution in Europe). Actually getting used to rigid working hours, productivity targets, and being tied to a place of work may not be natural to people whose recent history, for many, has been of a nomadic way of life. Therefore, there is a social and economic gain through this learning process which cannot be measured simply in financial terms.

On the other hand, it can be reasonably argued that because the government has been so paternalistic, and disguised unemployment was the norm in the public sector, that it will be beneficial for Saudis to experience the prospect of unemployment as it will bring a change in attitudes towards work. Whereas salaries are seen, by many, as a right regardless of productivity, a more competitive job market may encourage a different work ethic.

2. Access to Services

Another fear for society which came through in the survey results was the possible deprivation of the less well-off of some services now freely available. Such examples are healthcare and education. Because they are free, these services tend to be abused i.e. there is over-consumption. However, what would be unacceptable would be the pricing-out of people from this kind of market. Basic provision will still have to be provided by the government, but possibly on a less grand scale. Private suppliers are already in the market especially in specialist healthcare. It is envisaged that private healthcare and
education institutions will increase their market share both of specialist and general services.
Chapter Nine

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS
This study set out to analyse the attitudes of Saudi private investors towards privatisation within the specific context of the Saudi Arabian economy. Privatisation varies from country to country depending on circumstances and context. What is interesting is that although Britain may be regarded as a leading example of privatisation, what many countries would regard as "privatisation" (e.g. contracting out) has been part of the Saudi economic system since major oil reserves started to be exploited in the 1930's

However, "full privatisation" is now seriously being considered for a variety of reasons. The economic climate has changed and the boom years have been replaced by leaner times and the budget deficit is a major problem. The government obviously sees privatisation as a means of raising revenues and reducing expenditure. Through various Development Plans, the government has established the infrastructural base and it now believes that the economy and the private sector are mature enough to accept "privatisation". Saudi businessmen, on the whole, agree with this point of view. The survey showed that capital is available for privatisation projects, businessmen feel that investment can be very rewarding, and projects for privatisation have already been identified by them and these would be supported.

This is not to say that there are not any reservations. Lack of information is a problem. Privatisation is often equated with "competition". At this stage, the government policy is not clear and will probably be different from one privatisation project to another. It is likely that some privatisations will merely be a transfer of government monopolies to private monopolies, others will be attempts to introduce competition which it is hoped will increase economic
efficiency and make industries more responsive to the wants of consumers. At the same time, the social implications of privatisation have been debated. International experience indicates that privatisation generally leads to unemployment. In Saudi Arabia, it is hoped that this will be accommodated by a reduction in the expatriate workforce. In the short run, this may not be realistic as not enough Saudis, as yet, have the skills, or the will when it comes to more menial tasks, to replace their expatriate counterparts. As employees receive substantial benefits from public sector employment, the question arises as to how the government will maintain these benefits if there is large scale Saudi unemployment. Failure to do so could lead to social problems. This would also be the case if privatisation deprived people of essential goods and services. Saudi Arabia is a mixed economy. For example, healthcare is provided by both the private and public sectors. What would not be acceptable for society (and businessmen as part of that society) would be the pricing-out of the less well-off members of society when it came to buying essential goods and services. This is reflected by the survey results which indicate that the government should keep control of some sectors and at least have an interest in other areas to ensure basic provision of essentials.

However, privatisation will not be without cost. Saudi Arabia will have to face reality and accept the consequences if it wants change, efficiency, and productivity. This country has its own problems of hidden unemployment, low productivity and waste. Privatisation, it is hoped, will cut this fat and be a means of reform. Saudi Arabia needs to feel the financial pinch to appreciate the real value of wealth. Some Saudis, it may be suggested, need to experience hardship in order to appreciate job security.
What is abundantly clear from research is that although businessmen are ready for privatisation, it should not be a hasty decision. For all the deficiencies associated with the public sector in all countries, it must be remembered that in Saudi Arabia, the public sector has had considerable achievements in bringing the country's economic development to its present stage. Therefore, privatisation must be well planned, well timed, and have clear objectives. It should not simply be used to solve short term problems such as budgetary deficits. From the government point of view, once this one-off source of revenue is exhausted, what will replace it if oil revenues are still insufficient to cover government expenditure.

Out of the research, the following can be inferred:

Major Findings

I. The "economic problem" in Saudi Arabia is rooted in the structure of the Saudi Arabian economy which is dependent on one commodity - oil. Any fluctuation in the oil market affects the stability of the economy as a whole. Thus, financial short-falls are mainly caused by the decline in oil revenues.

2. Too much capital expenditure in the 1980's has led to insufficient current spending:
3. Major military spending drains away substantial amounts of savings that could otherwise be directed towards investment.

4. This situation has led to the examination of different and alternative policies to finance the budgetary deficit. "Privatisation" is such a policy.

5. Privatisation, however, is not a new phenomenon in Saudi Arabia. It has been there, in different shapes and forms, since the early days of industrial development.

6. Privatisation should be discussed, analysed, and examined within its context, because privatisation in India is not necessarily the same as privatisation in Britain or America. There are certain governing objectives and circumstances in every country and situation.

7. The introduction of privatisation should be gradual and selective.

8. The Saudi Arabian approach is characterised by a tendency to nationalise and then privatise when necessary and appropriate.

9. Another distinguishing element of Saudi economic policy is "consistency" in planning and policy, commitment, and operation. Thus privatisation comes as an extension of already pursued economic strategies, "diversification" being such a policy.

10. Foreign nationals are almost entirely excluded from participation.
11. It is observed that privatisation in Saudi Arabia is not accompanied by deregulation or liberalisation which would allow more entrants into the market.

12. The survey revealed that:
   a. The majority of the business community supports privatisation.
   b. Generally, private investors are not well informed about privatisation plans.
   c. The business environment in Saudi Arabia is stable and encourages investment.
   d. The private sector has adequate finance to buy large enterprises.
   e. Barriers to privatisation include inadequate information, manpower shortages, and the reluctance of public officials.
   f. Saudia and Saudi Telecom are the most favoured candidates for privatisation.
   g. The objectives of privatisation, from the business community’s perspective, should be improvement in quality and efficiency.

13. Barriers to privatisation include lack of adequate information and lack of skilled manpower.

14. There is no privatisation plan as such in Saudi Arabia. All privatisation activities are carried out, now and then, on an ad hoc basis or as a response to government initiatives.

15. There is a crucial need to develop finance market capabilities and strengthen the role of the banking system to provide medium / long term loans to replace the role of the government.
16. Special consideration should be paid to the economic and social implications of privatisation - especially to the "social responsibility" of the government with regard to utilities and services, e.g. water supplies, education and healthcare.

**Overall Suggestions**

Based on the findings, the following are generally recommended:

1. Objectives must be measurable and specific in terms of content. They must come out of the needs of the Saudi context and be clearly identified.

2. Privatisation should be gradual, in phases, and assessed and evaluated continually so as to build on success.

3. Projects should be carefully selected with vision to minimise any social implications and in order to maintain the image of the government 'in loco parentis'.

4. It should be ensured that privatisation in every aspect is investment led so returns can be usefully utilised for the benefit of the state and the people and not merely to solve financial problems.

5. Privatisation should be realistic in its time scale.

6. In practice, restructuring is sometimes carried out in order to make a project more attractive for sale. Restructuring is an action usually made to bridge the gap between the enterprise's present performance and the
quality standard that make it competitive. However, international experience shows:

- Physical and technical restructuring are best left to the purchasers who will do it better and more cheaply than the state; the purchase price should be discounted accordingly.

- Labour and management retrenchment are best handled by the state prior to sale; this invariably controversial dimension of restructuring is too politically difficult to leave to the new owners.

- Financial restructuring should be left to the private owner. But, prior to sale, it always requires heavy state involvement. By and large, the state absorbs the enterprise's debts and otherwise assists in cleaning up its balance sheet.

7. Special attention should be paid to how the privatisation programme can be managed. Such responsibility can be given to a board attached to the Ministry of Finance.

- A privatisation board, attached to the Ministry of Finance and National Economy, should be established. The members should be appointed from both the public and private sectors. The board must have specific responsibilities, such as
  - overall responsibility for privatisation plans
  - identification of projects
  - follow-up
Sub-committees could be assigned by the board for areas such as: Research and Development, Disputes, Information, and Reporting.

- Saudi Arabia would require expert assistance to implement the privatisation programme, especially for asset valuation and development of the financial market's capabilities. It would be advisable to seek such support from experienced international financial institutions or consultancy houses, at least in the early stages of development.

- It should be ensured that at least 25% of sale proceeds are directed towards investment. Privatisation must be investment led.

These suggestions can be incorporated in an action plan for privatisation which has the following components:

**The Privatisation Plan**

**Section One - Assessment of the Current Situation.**

In this section, a careful analysis is required to assess why privatisation is being proposed. Also, there needs to be identification of constraints, e.g. budgetary, information, and manpower.

**Section Two - Strategy and Objectives.**

The objectives should be directed to serve the interests of all partners in the privatisation programme, both government and private. The objectives must emphasise, as already mentioned, investment by the
state. The objectives must encourage privatisation to lead to increased services to the consumer.

**Section Three - Programmes and Targets.**

This section should include identified projects for privatisation. This identification must be the outcome of a carefully undertaken study process of who the alternative providers are. How competent are they? What are the consequences?

**Section Four - Technical Support.**

Enlist the support of professionals to prepare the financial and political impact assessment.

**Section Five - Marketing**

Marketing is a very important aspect of the privatisation programme. It is essential to raise public awareness. Obvious information such as what is being privatised, the cost of investment, the mechanism of share allocation, how, where and when to apply for shares are all important features of privatisation marketing. Less obvious is marketing to get the public to understand the benefits of privatisation and any politically motivated messages related to privatisation that the government may want to send.
Looking to the Future

Once, Arthur C. Clarke, former chairman of the British Interplanetary Society, wrote:

“Every problem has not one, but many, technological solutions. Unfortunately about 90% of the solutions are worse than the problem. Wisdom lies in finding the vital 10%.” (1)

Today, many countries seem hypnotised by the privatisation issue. Yet in absolute terms, what confronts us now is a temporary - though I am afraid prolonged - mismatch between our present needs, our immediately available resources, and our future development. In Saudi Arabia, the age of privatisation for the sake of perfect economic efficiency, let alone the redistribution of wealth, still lies light years ahead. With hope, enthusiasm and dedication, we now face this dangerous transition period.

---

Ideas for Further Research

By virtue of the fact that "privatisation" is a new phenomenon in many countries, and especially in Saudi Arabia, the implications of and returns to such a policy will have to await the outcome of further research. In line with this, several aspects, although already discussed to a limited extent, could possibly be investigated more thoroughly. The following suggestions are not intended to be definitive or mutually exclusive, as some overlap is inevitable. They include:

1. Economic Returns- possibly by using cost-benefit analysis techniques to determine the overall costs and benefits of privatisation in purely economic terms.

2. The Social Implications of Privatisation- to determine the socio-economic effects of privatisation on individuals, society in general, social policies, and social attitudes. The public sector, in Saudi Arabia, is by far the largest employer and provides considerable benefits for its
employees (in many ways acting as the "Welfare State"). What will be the effects of a change in this relationship?

3. The Returns to Small Shareholders- To determine to what extent privatisation has contributed to a wider ownership of capital and how this has affected the distribution of wealth in the Kingdom.

4. Research and Development- There is a need to assess the impact of privatisation on research and development, either after privatisation takes place or, in theory, before it. As projects are transferred to private hands, it is necessary for the future development of the country that progress in this field is maintained.

5. Contingency Planning- It may be premature, but it is worth considering the device of a "contingency plan for privatisation". In other words, what would happen if privatisation did not work and the "family silver" had already been sold?

6. Alternatives to Privatisation- The above points assume that privatisation has taken place. Although in many countries one of the motives for privatisation has been the failure of the public sector, in Saudi Arabia, however, the public sector has, in general, been a leading
factor towards economic development. The public sector may be extended, but not necessarily a failure. Therefore, it may be useful to research the benefits of private sector performance and see how far it would be possible to make adjustments and efficiency improvements in the public sector without privatisation, and without losing the perceived benefits of the public sector.

7. Privatisation- Expatriate Businessmen's Point of View. The perspective of Saudi businessmen has been explored. Would expatriate businessmen operating in the Kingdom have a similar point of view?

8. Privatisation-from an Islamic Perspective. Is privatisation and the concurrent and inevitable development of the financial system in keeping with Islamic principles? Will Islam be a stimulus to the process or a restraining influence? This is vital not only because Saudi Arabia is an Islamic country subject to Islamic law, but also because Saudi Arabia is seen as the centre of Islam and what happens here may influence thinking in other Islamic countries.

At the moment, Saudi industry competes in international markets but is protected at home. What would be the effects of exposing Saudi industry to international competition at home, and removing government subsidies and incentives that help it compete on an international scale?
Bibliography


7. Andic, F.: Privatization Theory and Policy, UNIDO, IPCT. 156 (Spec)


33. Chamber of Commerce & Industry, Eastern Province, Economic Indications.


43. El-Mallakh, R.: Saudi Arabia: Rush to Development, Croom Helm,


67. MOP: *Business Expectation*, Saudi Arabia, 1409H.


73. MOP: *Summary of the 4th Development Plan*, 1985-90.


APPENDIX
EXAMINATION OF
ATTITUDES
OF PRIVATE INVESTORS
TOWARDS PRIVATISATION
IN SAUDI ARABIA
Objectives of the Survey

1. To examine the attitudes of Private investor towards Privatisation in Saudi Arabia.

2. To identify the future role of businessmen and private investors in Privatisation.

3. To examine the reaction of private investors towards what can be Privatised? What can not be Privatised?
PROFILE

1. Name :
2. Age :
3. Occupation :
4. Educational Background (tick as appropriate)
   - Primary
   - Intermediate
   - Secondary
   - University Graduate
   - Post Graduate

5. Experience (tick as appropriate) in years between:
   - 5 - 10
   - 10-15
   - 15-20
   - 20-25
   - 25-30
   - 30-35

6. Nature of your Business (tick as appropriate):
   - Industry
   - Banking
   - Construction
   - Manufacturing
   - Services
   - Trade
   - Sales
   - Imports & Exports
   - Agriculture
   - Other (Specify):

7. Location of your Business Activities (tick as appropriate)
   - Riyadh
   - Dammam
   - Jeddah
I- Support and Attitudes

I-1 Do you generally support Privatisation?

☐ Yes  ☐ No

I-2 Would you support the introduction of Privatisation on Saudi Arabia on:

☐ large scale

☐ small scale

I-3 What are (in your opinion) the major objectives of Privatisation in Saudi Arabia that should be emphasized?

1.
2.
3.
4.

I-4 What are the major Government's Enterprises that you would recommend for immediate Privatisation?

1.
2.
3.
I-5 Are there any Government's monopolies that you think are totally unsuitable for Privatisation - and explain why?

1. ___________________ Reason: ___________________

2. ___________________ Reason: ___________________

3. ___________________ Reason: ___________________

I-6 The following projects are proposed for Privatisation-please tick as appropriate indicating your agreement or disagreement and the pattern of Privatisation.

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Monopolies</th>
<th>Agree</th>
<th>Dis-Agree</th>
<th>Methodology for Privatisation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Total Transfer to Pvt Sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Joint Public and Pvt. Ownership</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Govt. Awards some Contract to Pvt. Sector only</td>
</tr>
<tr>
<td>1.</td>
<td>Saudi Arabian Airlines</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>General Organisation for Rail Roads</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>General Organisation for Soil &amp; Grains</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Saudi Telecom</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Hospitals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Universities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Postal Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Sea Ports</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Air Ports</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Saudi ARAMCO</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

I-7 What is the role of Private Sector in Privatisation?

☐ To manage the Programme
☐ To provide the finance for it
☐ To participate in policy making & planning
☐ Other

Such as: 1. 
          2. 
          3.
I-8 In all prospective Privatisation projects the government (to ensure control) should retain:

- some shares
- substantial shares
- None

I-9 With the introduction of Privatisation, government funding to the Private sector should be:

- stopped
- reduced
- continued

I-10 The transfer of ownership of large government monopolies e.g. Saudi Telecom, Saudia Airlines, Rail Roads, Desalination Plants should be:

- Open to the general public
- Restricted to Private companies and institutions
- The general public and the Private Companies
- The general public, private companies and foreign companies
I-11 The participation of foreign companies (direct foreign investment) in Privatisation in Saudi Arabia should be:

- [ ] encouraged
- [ ] restricted
- [ ] not allowed

I-12 Public share holding in privatised projects should be encouraged on:

- [ ] large scale
- [ ] small scale
- [ ] restricted

I-13 Share holding should be restricted to:

- [ ] Saudi only
- [ ] Saudi & GCC State members only
- [ ] Saudi and All Arabs
- [ ] Non-restricted

I-14 Name three Government projects that you will personally be willing to invest in if privatised:

1.
2.
3.
I-15 How much of your saving you will be prepared to invest on proposed projects for Privatisation e.g: Saudi Telecom, Saudia, etc.

- 10 % - 60 %
- 20 % - 70 %
- 30 % - 80 %
- 40 % - 90 %
- 50 % - 100 %

I-16 Investment abroad is more beneficial than in Saudi Arabia.

- Yes - No

if 'yes' explain-why?

I-17 Investment and Business opportunities in Saudi Arabia are (tick as appropriate):

- Very rewarding
- Limited
- Risky

I-18 The private sector has large amount of reserves:

- In Saudi Arabia
- Out side Saudi Arabia
- I don't know

I-19 Do you think that the private sector and the general public are well informed about the future plans for Privatisation ?

- Yes - No
I-20 Do you think the Saudi Private Investor will accept and share the risks of Privatisation in term of capital and management?

☐ Yes  ☐ No

I-21 Control over important natural resources such as oil and other forms of mineral wealth should be in the hands of the government?

☐ Yes  ☐ No

I-22 Please state your views on the expected role of the private sector on Privatisation in Saudi Arabia.
Section II - Benefits

II-1 What generally do you see as the benefits of Privatisation?

1. 
2. 
3. 

II-2 What specific benefits of Privatisation Policy would you foresee in Saudi Arabia?

1. 
2. 
3. 

II-3 All benefits from Privatisation are only economic?

☐ Yes ☐ No

II-4 Which of the following benefits of Privatisation are expected most in Saudi Arabia?

☐ increase in economic efficiency
☐ improvement in Quality of service
☐ growth of the private sector
☐ expansion of services
☐ competition
☐ increase government revenues and balance the budget
☐ development of small businesses
☐ more distribution of wealth to the general public through shareholding

- 9 -
II-5 The impact of Privatisation on the development and growth of small business will be:

- very positive
- negative
- No impact at all
- I don't know

II-6 Privatisation will help in technology transfer?

- Yes
- No

II-7 Privatisation will help Saudi Arabia in its effort to have a free market economy?

- Yes
- No
Section III - Dis-advantages

III-1 What generally do you think the disadvantages of Privatisation?

1.
2.
3.

III-2 What specifically the disadvantages that Privatisation may lead to in Saudi Arabia?

1.
2.
3.

III-3 Privatisation may lead to unemployment in Saudi Arabia and scale down Saudiization?

☐ Yes  ☐ No

III-4 Privatisation of (some) Schools and Hospitals may deprive many people from such services.

☐ Yes  ☐ No

III-5 Privatisation may lead to some social problems in the society.

☐ Yes  ☐ No

if 'yes' such as: ________________________________
Section IV - Timing

IV-1 Do you think is it time for Privatisation in Saudi Arabia?

☐ Yes ☐ No

in both cases explain 'why'?

IV-2 Do you think Privatisation should have been introduced a long time ago?

☐ Yes ☐ No

if your answer is 'yes', How long?

IV-3 Do you think Saudi Arabia should not rush to massive Privatisation programme?

☐ Yes ☐ No

IV-4 'Privatisation' in Saudi Arabia should be delayed.

☐ Yes ☐ No

if your answer is yes explain why?
Section V - Constraints

V-1 What are generally the constraints of Privatisation in your opinion?
   1.
   2.
   3.

V-2 What are the specific constraints to Privatisation in your opinion in Saudi Arabia?
   1.
   2.
   3.

V-3 Do you think the bureaucracy on the public sector could slow down Privatisation in Saudi Arabia?
   ☐ Yes ☐ No

V-4 Do you think that Senior Official in the public sector and their attitudes are major obstacle towards Privatisation in Saudi Arabia?
   ☐ Yes ☐ No
   if 'yes' explain-why? ____________________________________________
Section VI - Business Environment

VI-1 Public sector is organised and efficient?

☐ Yes  ☐ No

VI-2 The public sector in Saudi Arabia is over extended.

☐ Yes  ☐ No

VI-3 The role of public sector in economic activities should be reduced?

☐ Yes  ☐ No

VI-4 The private sector in Saudi Arabia

☐ Developed  ☐ Underdeveloped

VI-5 The private sector in Saudi Arabia is more organised and efficient than the public sector.

☐ Yes  ☐ No.

VI-6 The share of private sector in business and economy will be increasing without necessary selling any public owned units?

☐ Yes  ☐ No

VI-7 The Saudi Financial Market is:

☐ Organised

☐ Unorganised
VI-8 The Saudi Financial Market provide adequate support to the private sector.

☐ Yes     ☐ No

VI-9 The Business Law in Saudi Arabia is:

☐ Comprehensive
☐ Adequate
☐ Inadequate

VI-10 Privatisation in Saudi Arabia can be implemented without Stock market.

☐ Yes     ☐ No

VI-11 Which in your opinion would benefit most from Privatisation?

☐ The Public Sector by getting rid of some of its responsibility.

☐ The Private Sector by creating new business opportunities.

VI-12 Do you think the Private Sector has adequate finance to buy large government monopolies?

☐ Yes     ☐ No

VI-13 Do you think the Private Sector has adequate experience to run large government monopolies?

☐ Yes     ☐ No
Section VII - Mechanics and Structure

VII-1 If a Government Project is privatised its management should be changed?

☐ Yes ☐ No

VII-2 Privatised projects should be sold:

☐ Regardless of their existing deficiency
☐ Deficiencies should be solved prior to the sale
☐ I don't know

VII-3 The price of a privatised project:

☐ Should be decided by bidding
☐ Government should pre-set a fixed price

VII-4 Privatisation should be carried out through a specially designed plan.

☐ Yes ☐ No

VII-5 If a Planning Committee is set up for Privatisation in Saudi Arabia its members should come from:

☐ Public Sector only
☐ Private Sector only
☐ Public & Private Sector
☐ Public/Private Sector together with outside Professional Consultants
**PROFILE**

**EXPERIENCE IN YEARS**

<table>
<thead>
<tr>
<th>Years</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 YEARS OR LESS</td>
<td>7</td>
<td>15%</td>
</tr>
<tr>
<td>10 - 15 YEARS</td>
<td>15</td>
<td>32%</td>
</tr>
<tr>
<td>15 - 20 YEARS</td>
<td>4</td>
<td>9%</td>
</tr>
<tr>
<td>20 - 25 YEARS</td>
<td>10</td>
<td>21%</td>
</tr>
<tr>
<td>25 - 30 YEARS</td>
<td>3</td>
<td>6%</td>
</tr>
<tr>
<td>30 - 35 YEARS</td>
<td>2</td>
<td>4%</td>
</tr>
<tr>
<td>NO RESPONSE</td>
<td>6</td>
<td></td>
</tr>
</tbody>
</table>

**EDUCATIONAL BACKGROUND**

<table>
<thead>
<tr>
<th>Level</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRIMARY</td>
<td>1</td>
<td>2%</td>
</tr>
<tr>
<td>INTERMEDIATE</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>SECONDARY</td>
<td>3</td>
<td>6%</td>
</tr>
<tr>
<td>UNIV. GRADUATE</td>
<td>20</td>
<td>43%</td>
</tr>
<tr>
<td>POST GRADUATE</td>
<td>19</td>
<td>40%</td>
</tr>
<tr>
<td>NO RESPONSE</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

**AGE OF RESPONDENTS**

<table>
<thead>
<tr>
<th>Years</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 YEARS OR LESS</td>
<td>3</td>
<td>6%</td>
</tr>
<tr>
<td>31 - 40 YEARS</td>
<td>16</td>
<td>34%</td>
</tr>
<tr>
<td>41 - 50 YEARS</td>
<td>15</td>
<td>32%</td>
</tr>
<tr>
<td>51 - 60 YEARS</td>
<td>4</td>
<td>9%</td>
</tr>
<tr>
<td>NO RESPONSE</td>
<td>9</td>
<td></td>
</tr>
</tbody>
</table>
1) GENERAL SUPPORT FOR PRIVATISATION
   - \( \text{Y E S} \): 43 (91%)
   - \( \text{N O} \): 4 (9%)

2) INTRODUCTION OF PRIVATISATION IN SAUDI ARABIA ON THE FOLLOWING:
   - \( \text{LARGE SCALE} \): 30 (64%)
   - \( \text{SMALL SCALE} \): 17 (36%)

3) MONOPOLIES TO BE PRIVATIZED:
   - 4.1 SAUDI ARABIAN AIRLINES: 44 (94%)
   - 4.2 GEN ORGN FOR RAIL ROADS: 39 (83%)
   - 4.3 GEN ORGN FOR SOIL & GRAINS: 22 (47%)
   - 4.4 SAUDI TELECOM: 42 (89%)
   - 4.5 HOSPITALS: 27 (57%)
   - 4.6 UNIVERSITIES: 21 (45%)
   - 4.7 POSTAL SERVICES: 30 (64%)
   - 4.8 SEA PORTS: 26 (55%)
   - 4.9 AIR PORTS: 22 (47%)
   - 4.10 SAUDI ARAMCO: 21 (45%)

4) IN PRIVATISATION THE GOVERNMENT (TO ENSURE CONTROL), SHOULD RETAIN:
   - \( \text{SOME SHARES} \): 32 (68%)
   - \( \text{SUBSTANTIAL SHARES} \): 4 (9%)
   - \( \text{NON} \): 11 (23%)

5) IN PRIVATISATION THE GOVT FUNDING TO THE PRIVATE SECTOR SHOULD BE:
   - \( \text{STOPPED} \): 2 (4%)
   - \( \text{REDUCED} \): 30 (64%)
   - \( \text{CONTINUED} \): 13 (28%)
   - \( \text{NO RESPONSE} \): 2

6) TRANSFER OF OWNERSHIP OF LARGE GOVT MONOPOLIES e.g. SHOULD BE:
   - \( \text{OPEN TO GEN PUBLIC} \): 15 (32%)
   - \( \text{RESTRICTED TO PRIVTE & INSTITUT} \): 0 (0%)
   - \( \text{GEN PUBLIC & PRIVTE COMPANIES} \): 22 (47%)
   - \( \text{GEN PUBLIC PRIVTE & FOREIGN COMP} \): 10 (21%)

7) PARTICIPATION OF FOREIGN COMPANIES (DIRECT INVESTMENT) SHOULD BE:
   - \( \text{ENCOURAGED} \): 19 (40%)
   - \( \text{RESTRICTED} \): 21 (45%)
   - \( \text{NOT ALLOWED} \): 7 (15%)

DATE: 02/07/94
SUPPORT AND ATTITUDE

8) PUBLIC SHARE HOLDING IN PRIVATISED PROJECTS SHOULD BE ENCOURAGED ON:
   - LARGE SCALE 42 (89%)
   - SMALL SCALE 4 (9%)
   - RESTRICTED 1 (2%)

9) SHARE HOLDING SHOULD BE RESTRICTED TO THE FOLLOWING:
   - SAUDI ONLY 15 (32%)
   - SAUDI & GCC MEMBERS 14 (30%)
   - SAUDI & ALL ARABS 6 (13%)
   - NON-RESTRICTED 11 (23%)
   - NO RESPONSE 1

10) HOW MUCH OF YOUR SAVINGS WILL BE INVESTED IN PRIVATISATION PROJECTS
   - 10% 6 (13%)
   - 20% 10 (21%)
   - 30% 11 (23%)
   - 40% 2 (4%)
   - 50% 9 (19%)
   - 60% 2 (4%)
   - 70% 1 (2%)
   - 80% 0 (0%)
   - 90% 0 (0%)
   - 100% 3 (6%)
   - NO RESPONSE 3

11) INVESTMENT & BUSINESS OPPORTUNITIES IN SAUDI ARABIA ARE:
   - VERY REWARDING 31 (66%)
   - LIMITED 10 (21%)
   - RISKY 6 (13%)

12) THE PRIVATE SECTOR HAS LARGE AMOUNT OF RESERVES:
   - IN SAUDI ARABIA 25 (53%)
   - OUTSIDE SAUDI 21 (45%)
   - DONT KNOW 1 (2%)

13) ARE THE PRIVATE SECTOR & GENERAL PUBLIC INFORMED ON PRIVATISATION PLANS:
   - YES 7 (15%)
   - NO 39 (83%)
   - NO RESPONSE 1

DATE: 02/07/94
14) WILL THE SAUDI INVESTOR SHARE THE RISKS OF PRIVATISATION

- **Yes**
  - 41 responses, 87%
- **No**
  - 6 responses, 13%

15) CONTROL OVER NATURAL RESOURCES SUCH AS OIL AND MINERAL WEALTH SHOULD BE IN THE HANDS OF THE GOVT

- **Yes**
  - 37 responses, 79%
- **No**
  - 8 responses, 17%
- **No Response**
  - 2 responses
1) ALL BENEFITS FROM PRIVATISATION ARE ONLY ECONOMIC?
   o Y E S  4  9%
   o N O    43  91%

2) WHICH OF THE FOLLOWING BENEFITS ARE EXPECTED MOST IN SAUDI ARABIA
   o INCREASE IN ECONOMIC EFFICIENCY  34  72%
   o IMPROVEMENT IN QUALITY SERVICE  36  77%
   o GROWTH OF THE PRIVATE SECTOR  31  66%
   o EXPANSION OF SERVICES  25  53%
   o COMPETITION  31  66%
   o INCREASE GOVERNMENT REVENUES  23  49%
   o DEVELOPMENT OF SMALL BUSINESSES 21  45%
   o MORE DISTRIBUTION OF WEALTH  35  74%

3) IMPACT OF PRIVATISATION ON THE DEV AND GROWTH OF SMALL BUSINESS ARE:
   o VERY POSITIVE  36  77%
   o NEUTRAL  3  6%
   o NO IMPACT AT ALL  2  4%
   o I DON'T KNOW  6  13%

4) PRIVATISATION WILL HELP IN TECHNOLOGY TRANSFER?
   o Y E S  44  94%
   o N O    2  4%
   o NO RESPONSE  1

5) PRIVATISATION WILL HELP SAUDI ARABIA EFFORT TO HAVE A FREE MARKET
   o Y E S  45  96%
   o N O    1  2%
   o NO RESPONSE  1
### DIS - ADVANTAGES

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1) PRIVATISATION MAY LEAD TO UNEMPLOYMENT AND SCALE DOWN SAUDIZATION</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Y E S</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td>N O</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>NO RESPONSE</td>
<td>3</td>
</tr>
<tr>
<td>2) PRIVATISATION OF SCHOOLS &amp; HOSPITALS MAY DEPRIVE PEOPLE FROM SERVICES</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Y E S</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>N O</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>NO RESPONSE</td>
<td>2</td>
</tr>
<tr>
<td>3) PRIVATISATION MAY LEAD TO SOME SOCIAL PROBLEMS IN THE SOCIETY</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Y E S</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>N O</td>
<td>24</td>
</tr>
<tr>
<td></td>
<td>NO RESPONSE</td>
<td>1</td>
</tr>
</tbody>
</table>

DATE: 02/07/94
TIMING

1) DO YOU THINK IT'S TIME FOR PRIVATISATION IN SAUDI ARABIA

- YES 44 94%
- NO 2 4%
- NO RESPONSE 1 2%

2) DO YOU THINK PRIVATISATION SHOULD HAVE BEEN INTRODUCED A LONG TIME AGO?

- YES 10 21%
- NO 36 77%
- NO RESPONSE 1

3) DO YOU THINK SAUDI ARABIA SHOULD RUSH TO MASSIVE PRIVATISATION

- YES 29 62%
- NO 16 34%
- NO RESPONSE 2

4) PRIVATISATION IN SAUDI ARABIA SHOULD BE DELAYED

- YES 2 4%
- NO 44 94%
- NO RESPONSE 1
### Constraints

1) **DO YOU THINK THE BUREAUCRACY IN THE PUBLIC SECTOR COULD SLOW DOWN PRIVATISATION**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>No Response</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>35</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td><strong>%</strong></td>
<td>74%</td>
<td>21%</td>
<td>5%</td>
</tr>
</tbody>
</table>

2) **DO YOU THINK THE SENIOR OFFICIALS IN PUBLIC SECTOR ARE MAJOR OBSTACLES:**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>No Response</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>20</td>
<td>22</td>
<td>5</td>
</tr>
<tr>
<td><strong>%</strong></td>
<td>43%</td>
<td>47%</td>
<td></td>
</tr>
</tbody>
</table>

**DATE:** 02/07/94
**BUSINESS ENVIRONMENT**

1) **PUBLIC SECTOR IS ORGANISED AND EFFICIENT**
   - Yes: 11 (23%)
   - No: 33 (70%)
   - No Response: 3

2) **PUBLIC SECTOR IN SAUDI ARABIA IS OVER EXTENDED**
   - Yes: 30 (64%)
   - No: 15 (32%)
   - No Response: 2

3) **THE ROLE OF PUBLIC SECTOR IN ECON. ACTIVITIES SHOULD BE REDUCED**
   - Yes: 32 (68%)
   - No: 14 (30%)
   - No Response: 1

4) **THE PRIVATE SECTOR IN SAUDI ARABIA**
   - Developed: 27 (57%)
   - Under Develop: 18 (38%)
   - No Response: 2

5) **THE PRIVATE SECTOR IS MORE ORGANISED & EFFICIENT THAN PUBLIC SECTOR**
   - Yes: 42 (89%)
   - No: 5 (11%)

6) **SHARE OF PRIVATE SECTOR IN BUSINESS WILL BE INCREASING .....**
   - Yes: 24 (51%)
   - No: 21 (45%)
   - No Response: 2

7) **THE SAUDI FINANCIAL MARKET IS**
   - Organised: 20 (43%)
   - Unorganised: 27 (57%)
BUSINESS ENVIRONMENT

8) THE SAUDI FINANCIAL MARKET PROVIDES SUPPORT TO THE PRIVATE SECTOR
   - YES: 20 (43%)
   - NO: 25 (53%)
   - NO RESPONSE: 2

9) THE BUSINESS LAW IN SAUDI ARABIA
   - COMPREHENSIVE: 5 (11%)
   - ADEQUATE: 11 (23%)
   - INADEQUATE: 30 (64%)
   - NO RESPONSE: 1

10) PRIVATISATION CAN BE IMPLEMENTED WITHOUT STOCK MARKET:
    - YES: 16 (34%)
    - NO: 28 (60%)
    - NO RESPONSE: 3

11) WHICH IN YOUR OPINION WOULD BENEFIT MOST FROM PRIVATISATION:
    - PUBLIC SECTOR: 14 (30%)
    - PRIVATE SECTOR: 41 (87%)

12) PRIV. SECTOR HAS ADEQUATE FINANCE TO BUY LARGE GOVT. MONOPOLIES:
    - YES: 38 (81%)
    - NO: 8 (17%)
    - NO RESPONSE: 1

13) PRIV. SECTOR HAS ADEQUATE EXPERIENCE TO RUN LARGE GOVT. MONOPOLIES:
    - YES: 30 (64%)
    - NO: 13 (28%)
    - NO RESPONSE: 4
1) IF A GOVT. PROJECT IS PRIVATISED
   ITS MANAGEMENT SHOULD BE CHANGED
   - YES  39  83%
   - NO   5   11%
   - NO RESPONSE 3

2) PRIVATISED PROJECTS SHOULD BE SOLD:
   - REGARDLESS OF DEFICIENCY  20  43%
   - DEFICIENCIES SHOULD BE SOLVED 20  43%
   - I DON'T KNOW  6   13%
   - NO RESPONSE  1

3) THE PRICE OF A PRIVATISED PROJECT:
   - SHOULD BE DECIDED BY BIDDING 29  62%
   - GOVT. SHOULD PRE-SET PRICE 18  38%

4) PRIVATISATION SHOULD BE CARRIED
   THRU A SPECIALLY DESIGNED PLAN
   - YES  45  96%
   - NO   1   2%
   - NO RESPONSE 1

5) THE MEMBERS OF PRIVATISATION
   PLANNING COMMITTEE SHOULD COME FROM
   - PUBLIC SECTOR ONLY 1  2%
   - PRIVATE SECTOR ONLY 1  2%
   - PRIVATE & PUBLIC SECTOR 11  23%
   - PRIV & PUB AND PROF. CONSULTANT 34  73%