

Mohamed A. Ramady

The Saudi Arabian Economy

Policies, Achievements and Challenges

Second Edition



Springer

CHAPTER 9

FOREIGN TRADE: CHANGING COMPOSITION AND DIRECTION

Overview

- Saudi Arabia **leads the Arab world** in both exports and imports, and ranks among the **top five Muslim countries**, along with Turkey, Malaysia, Indonesia and the UAE.
- The need to trade is based on economic principles that stipulates that **countries trade with each other based on absolute or comparative advantage.**

(Contd...)

- Countries **specialize in exporting commodities** which gives them cost of production advantage. **Saudi Arabia has advantages over other high cost oil producers.**
- Saudi Arabia does **not** have an advantage over production of non-oil commodities, with the exception of petrochemicals. The challenge for Saudi Arabia is to become **competitive in non-oil exports.**
- This will not be easy, as according to the World Trade Organization (WTO), the Middle East's global export trade share has fallen.

Table 9.1 GDP and merchandise trade by region, 2005-07
(Annual percentage change at constant prices)

	<i>GDP</i>			<i>Exports</i>			<i>Imports</i>		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
World	3.3	3.7	3.4	6.5	8.5	5.5	6.5	8.0	5.5
North America	3.1	3.0	2.3	6.0	8.5	5.5	6.5	6.0	2.5
United States	3.1	2.9	2.2	7.0	10.5	7.0	5.5	5.5	1.0
South and Central America	5.6	6.0	6.3	8.0	4.0	5.0	14.0	15.0	20.0
Europe	1.9	2.9	2.8	4.0	7.5	3.5	4.5	7.5	3.5
European Union (27)	1.8	3.0	2.7	4.5	7.5	3.0	4.0	7.0	3.0
Commonwealth of Independent States	6.7	7.5	8.4	3.5	6.0	6.0	18.0	21.5	18.0
<i>Africa and Middle East</i>	<i>5.6</i>	<i>5.5</i>	<i>5.5</i>	<i>4.5</i>	<i>1.5</i>	<i>0.5</i>	<i>14.5</i>	<i>6.5</i>	<i>12.5</i>
Asia	4.2	4.7	4.7	11.0	13.0	11.5	8.0	8.5	8.5
China	10.4	11.1	11.4	25.0	22.0	19.5	11.5	16.5	13.5
Japan	1.9	2.4	2.1	5.0	10.0	9.0	2.5	2.5	1.0
India	9.0	9.7	9.1	21.5	11.0	10.5	28.5	9.5	13.0
Newly industrialized economies ^a	4.9	5.5	5.6	8.0	12.5	8.5	5.0	8.5	7.0

^a Hong Kong, China; Republic of Korea; Singapore and Chinese Taipei.

Source: WTO Secretariat.

The causes of trade: basic models

- Free trade has come under fire recently and some economists argue that in a fiercely competitive and globalize world, some countries have **not benefited** from open trade policies.
- Others argue that gains from trade is better than *autarky* or **self-sufficiency**, and that even restricted trade is better than autarky.

(Contd....)

- A full explanation of gains from trade should link them to the **causes of trade**- to the elements that give rise to divergence between autarky and free trade prices. Such **elements** include:
 - Differences in technology
 - Difference in natural endowments
 - Economies of scale (size)
 - Elimination of monopoly power.
- Other factors include the **stimulation of domestic companies to face competition and knowledge “spill-over” effects from international trade.**

Table 9.2. Trade model theories

	<i>Traditional trade theory Ricardo, Heckscher-Ohlin</i>	<i>New trade theory Krugman (1980)</i>	<i>Heterogeneous firms models Melitz (2003)</i>
Gains from trade (causes)			
Specialization	Yes	No	No
Economies of scale	No	Yes	Yes
Pro-competitive	No	Yes	No
Variety	No	Yes	No
Aggregate productivity (through selection/ reallocation)	No	No ¹	Yes
Trade patterns			
Inter-industry	Yes	No	No
Intra-industry	No	Yes	Yes
Exporters and non-exporters within industries	No	No	Yes
Distribution			
Trade liberalization affects relative factor rewards	Yes	No	No

¹ In the Krugman model, 'productivity' in the integrated market also increases in the sense that the same total amount is produced at lower average cost due to exploitation of scale economies. However, the Krugman model is silent about which firms remain in business, since it does not include differences among firms. Once firms are distinguished according to their productivity level, as in the Melitz model, the exit of less productive firms itself leads to improvements in overall industry productivity.

Source: WTO

Saudi industrial and export strategy

- Since the early phase of Saudi economic development, there has been a debate on what type of **industrialization strategy** to follow:
 - import substitution **or**
 - export led strategy
- While both are **not** mutually exclusive and co-exist, depending on the phase of economic development, yet each has an inherent appeal.

(Contd....)

(A) *Import substitution strategy:*

- Encourages investment in both private and public sector to establish viable industries that **gradually replaces foreign imports**, reduction of foreign exchange outflow, inward investments and job creation. Disadvantages are the opportunity cost of continued protection of “infant” industries.

(B) *Export-oriented industrial strategy:*

- More pro-active, and requires fundamental structural, administrative and **capacity changes** in domestic economy. Disadvantages are the intensity and level of international competition.

Table 9.3. Obstacles facing Saudi industrial sector development and solutions

<i>Obstacles</i>	<i>Possible Solution</i>
<ul style="list-style-type: none"> • Skilled manpower shortage at both technical and managerial levels. 	<ul style="list-style-type: none"> • Expansion of specialized vocational and technical institutions, development of market led courses at universities, international scholarships for areas deemed to be of national priority, on-the-job training.
<ul style="list-style-type: none"> • Transfer of technology and its continuous application, and maintenance of such new technology 	<ul style="list-style-type: none"> • Establishment of joint venture companies with access to foreign companies R+D processes, the establishment of internal R+D centers and specialized research institutions at universities, the supports for commercialization and new patent applications.
<ul style="list-style-type: none"> • Potential dumping of foreign goods 	<ul style="list-style-type: none"> • Application to international bodies such as WTO for redress and imposition of penalties on such foreign companies.

Evolving pattern and nature of Saudi exports

- Both Saudi imports and exports have risen sharply since the early 1970's, **and non-oil exports have registered a steady increase.**
- The **composition** of Saudi exports, while still predominantly hydrocarbon based, has seen a gradual increase in exports in foodstuffs, electrical machinery, construction material and re-exports.
- In order to achieve such a **sustained export led initiative**, the government has established Saudi export assistance agencies to assist the private sector at home and abroad to overcome marketing deficiencies and export guarantee payments.

Table 9.4. Saudi trading patterns 1970-2008 (SR Billions)

<i>Year</i>	<i>Imports</i>	<i>Total exports</i>	<i>Non-oil exports</i>
1970	3.197	10.907	0.800
1975	14.823	104.412	1.160
1981	119.298	405.481	4.635
1991	108.934	178.636	15.328
2001	116.931	254.898	30.182
2005	222.985	677.144	71.263
2007	338.088	874.403	104.468
2008	431.753	1,175.354	120.182

Source: SAMA

Table 9.5. Composition of Saudi exports 1984-2008 (SR Billion)

<i>Composition</i>	<i>1984</i>	<i>1993</i>	<i>2000</i>	<i>2008</i>
• Foodstuff	0.166	1.656	1.700	8.875
• Petrochemicals	1.489	8.348	15.930	62.738
• Base Metals	0.185	0.869	1.982	10.503
• Electrical Equipment/ Machines	0.008	0.460	0.951	6.388
• Construction material	Nil	1.273	2.357	10.206
• Re-exports	2.505	1.527	1.886	21.472
• TOTAL	4.353	14.134	24.806	120.182

Source: SAMA

Table 9.6 Saudi export assistance agencies

<i>Agency</i>	<i>Function</i>
<ul style="list-style-type: none">• Saudi Export Program of Saudi Fund for Development (SFD)	<ul style="list-style-type: none">• Established in 1999 to provide finance and insurance for non-oil exports. Helps Saudi exporters to receive export proceeds due to importers inability to pay, by providing 90% non-payment risk. In 2008 the program provided SR 838 million in export finance and SR 3.525 billion in guarantees.
<ul style="list-style-type: none">• Saudi Export Development Centre (SEDC)	<ul style="list-style-type: none">• Established in 1985 under the auspices of the Chambers of Commerce and assists exporters by making proposals and studies, conducting research on export potential and new markets, assisting with marketing plans and assisting with internal and external trade missions, as well as providing import regulations of designated target countries to Saudi members.
<ul style="list-style-type: none">• Saudi Export Development Authority (SEDA)	<ul style="list-style-type: none">• Established in 2007 by the Council of Ministers. The SEDA 's objectives are in setting the state's policies of developing non-oil exports, increasing the export sector's competitive capacity, developing policies and legislation and improving the export environment and providing incentives. SEDA also prepares studies on export opportunities and organizing symposia and conferences.

Saudi imports – also diversifying

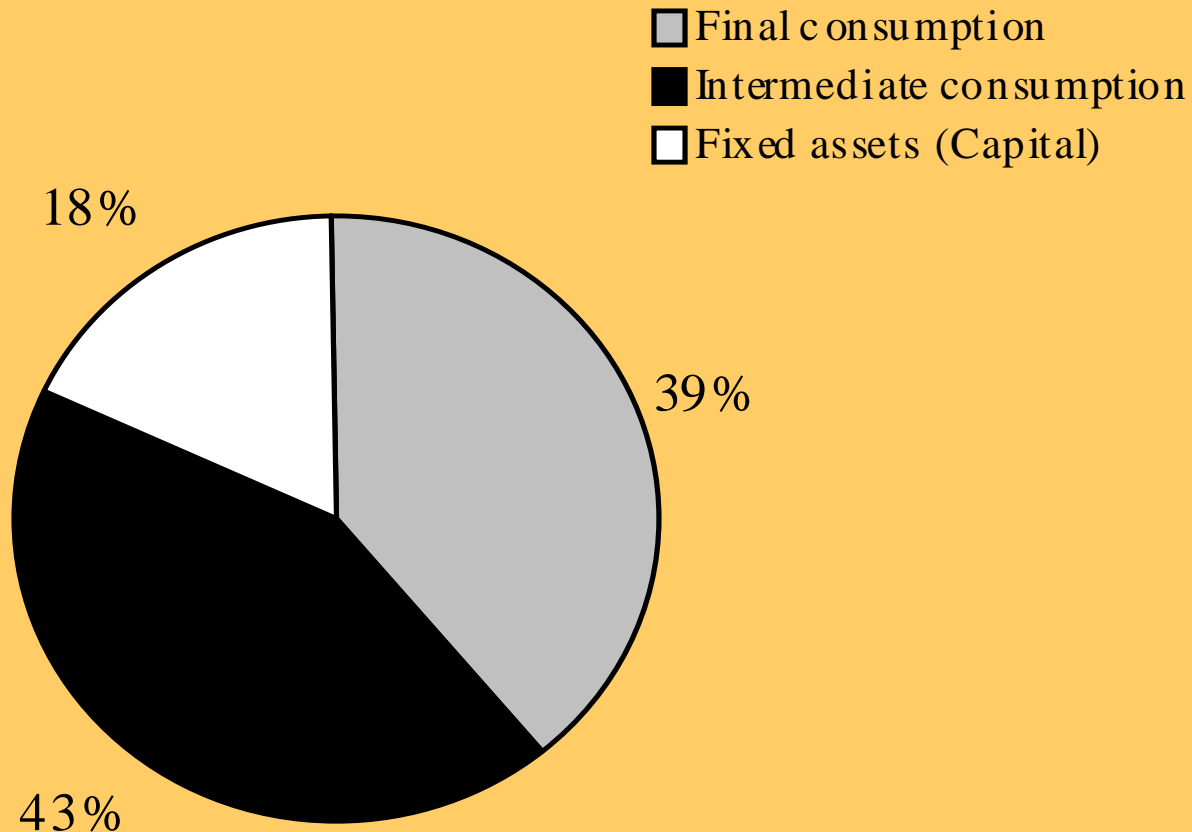
- **Imports** have witnessed a **sustained rise** due to increasing government expenditure during boom periods, a growing population base, and an open trade policy with the exception of religiously banned products such as alcohol and pork.
- By 2008, the composition of imports had registered a **shift** towards machines and appliances, transport equipment, chemicals, and foodstuffs. In 1970, the import of foodstuff accounted for 31% of total imports, but this had fallen to 15% levels by 2008 due to the growth of a vibrant domestic food industry.
- By 2008, most Saudi imports were of a **finished product** nature (72%), with 24% representing semi-finished products, while 18% were fixed assets.

Table 9.7. Saudi Arabia – imports by major commodity groups (1970-2008) (SR Billions)

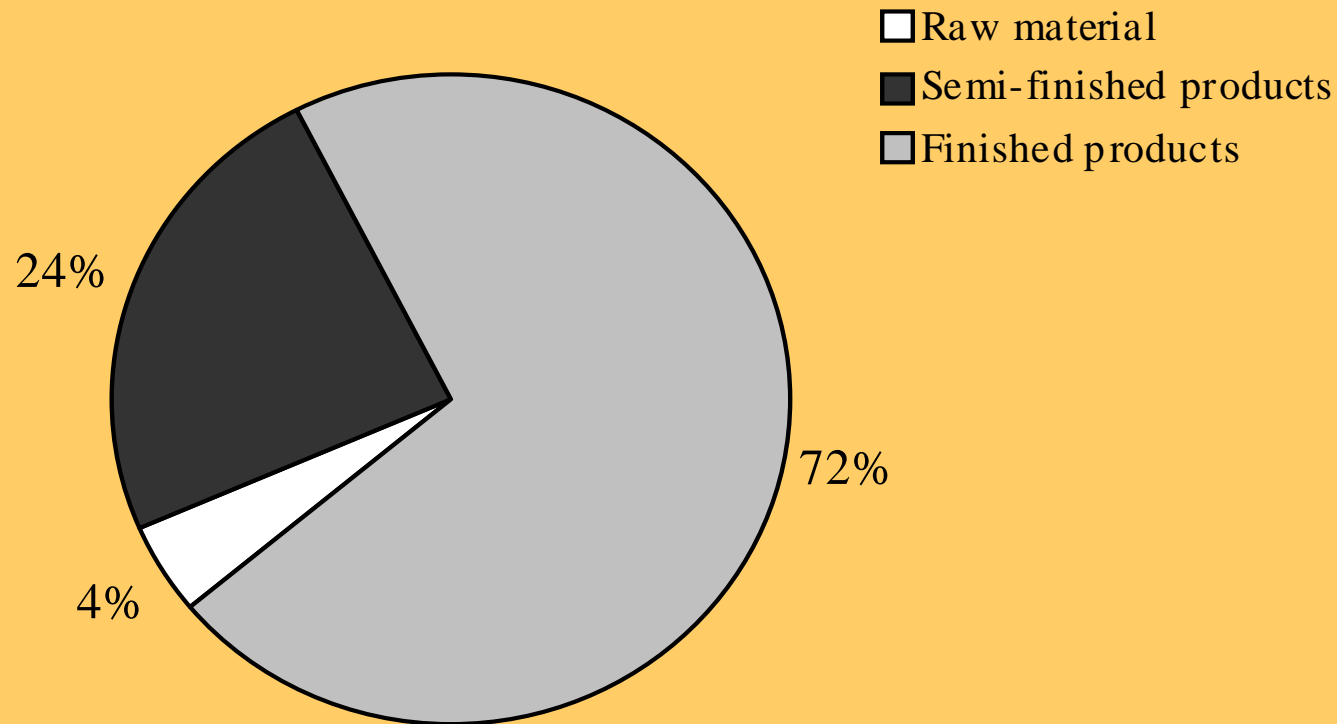
<i>Commodity Group</i>	<i>1970</i>	<i>1984</i>	<i>2000</i>	<i>2006</i>	<i>2008</i>
• Machines, appliances	0.590	28.410	24.982	67.302	117.318
• Foodstuffs	1.011	18.739	20.258	35.547	62.199
• Chemicals	0.355	11.625	14.716	33.394	53.039
• Textiles/Clothing	0.157	3.605	7.573	10.281	13.875
• Metals and their Products	0.300	14.183	8.895	38.626	66.012
• Wood and Jewelry	0.416	7.790	8.769	4.256	8.355
• Transport Equipment	0.428	15.916	19.996	50.453	77.619
• Other goods	0.042	3.716	3.072	21.543	33.336
• TOTAL SR Billion	3.299	103.984	108.261	261.402	431.753

Source: SAMA

Figure 9.1 (A) Import by utilization of items, 2008 (SR billion)



(B) Imports by nature of items



Source: SAMA.

Saudi imports by origin-the East moves up

- It is not just the composition of imports that has changed over time, but **the origin of these imports**, with a significant shift towards imports from Asia and **China** recorded between 2001 and 2008.
- On the whole, Saudi trade direction is largely determined by the **private sector** based on commercial relations, agencies held, profitability margins and level of comfort in dealing with counterparties. Some government to government deals take place, but essentially **trade is private sector driven**.

(Contd....)

- While the USA is still the Kingdom's premier trading partner, the level of **Chinese imports have moved it to second place** and Japan into third place. Other significant trading partners are Germany, Italy and South Korea.
- Imports from the Arab and Muslim world accounted for 11% in 2008.
- Most Saudi imports are financed through commercial bank letter of credit.

Figure 9.2. Saudi imports by origin (2000 and 2008)

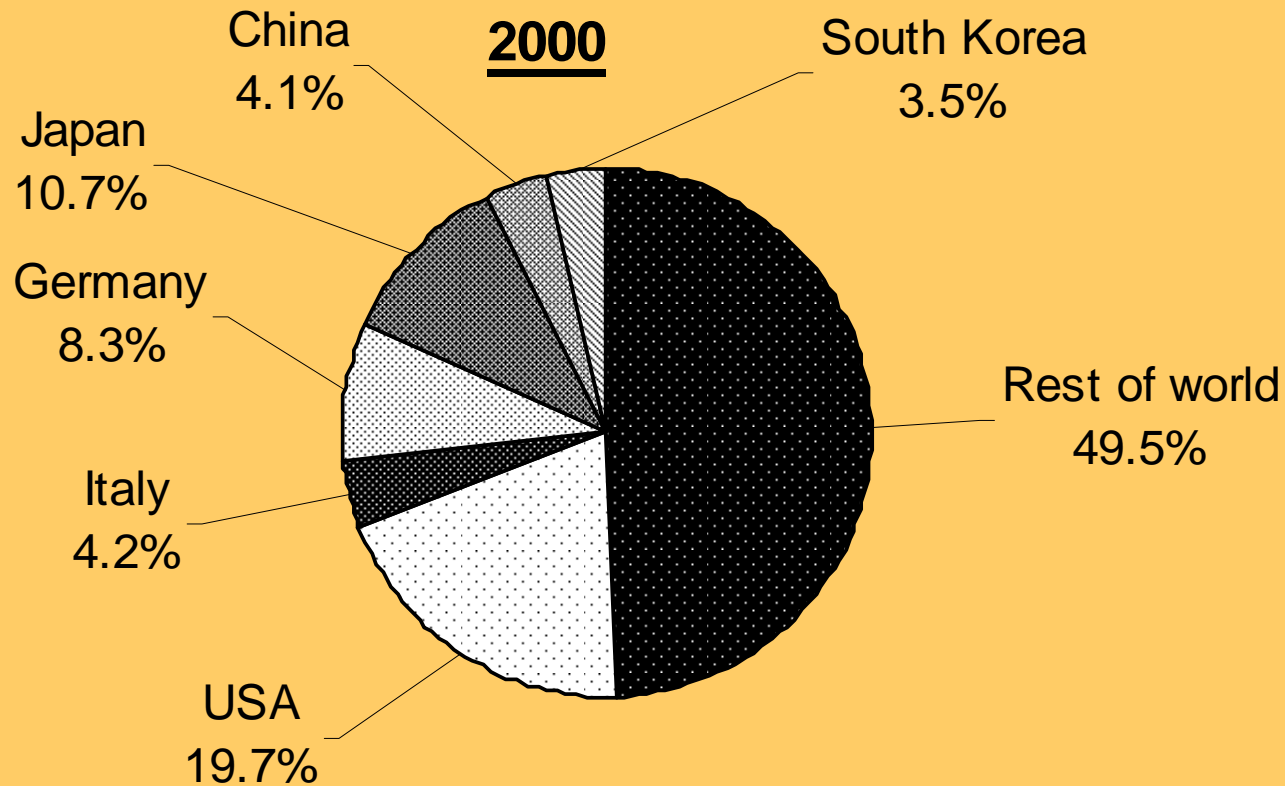


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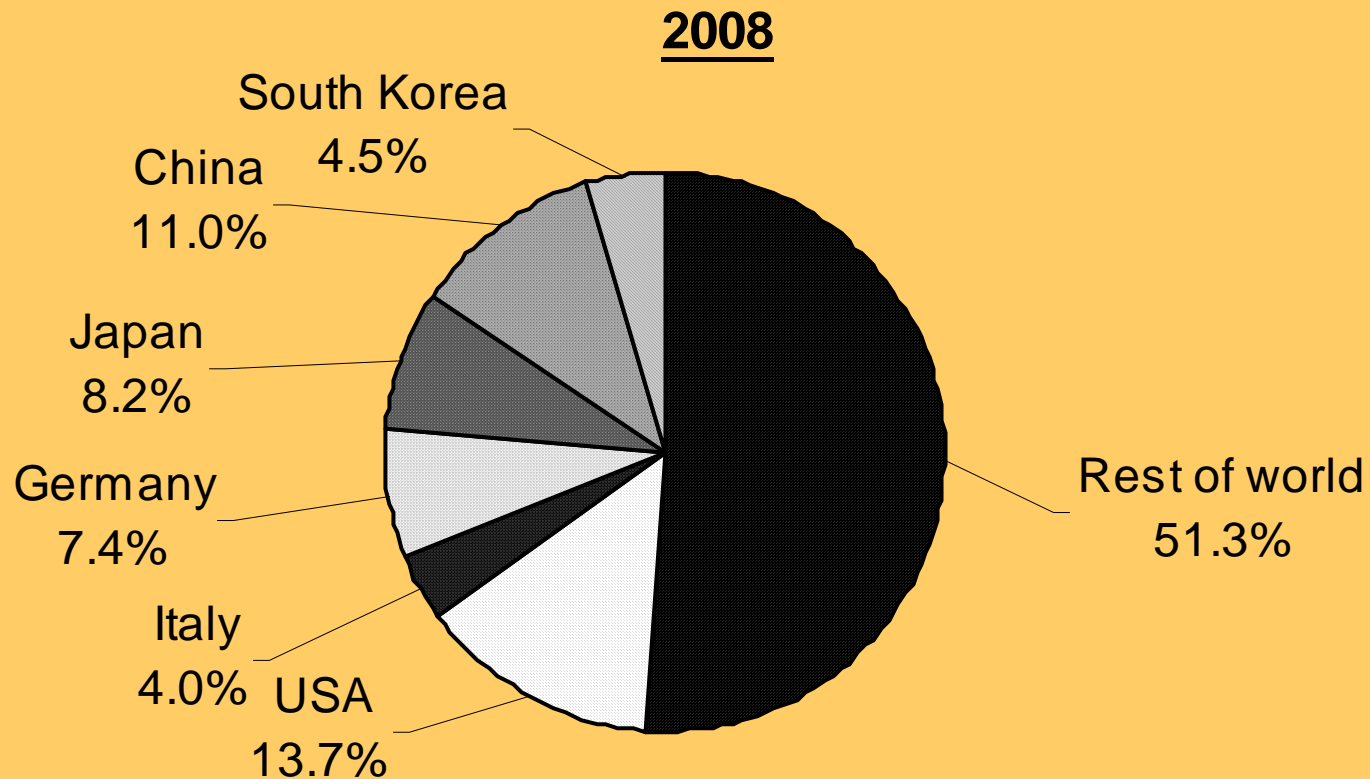
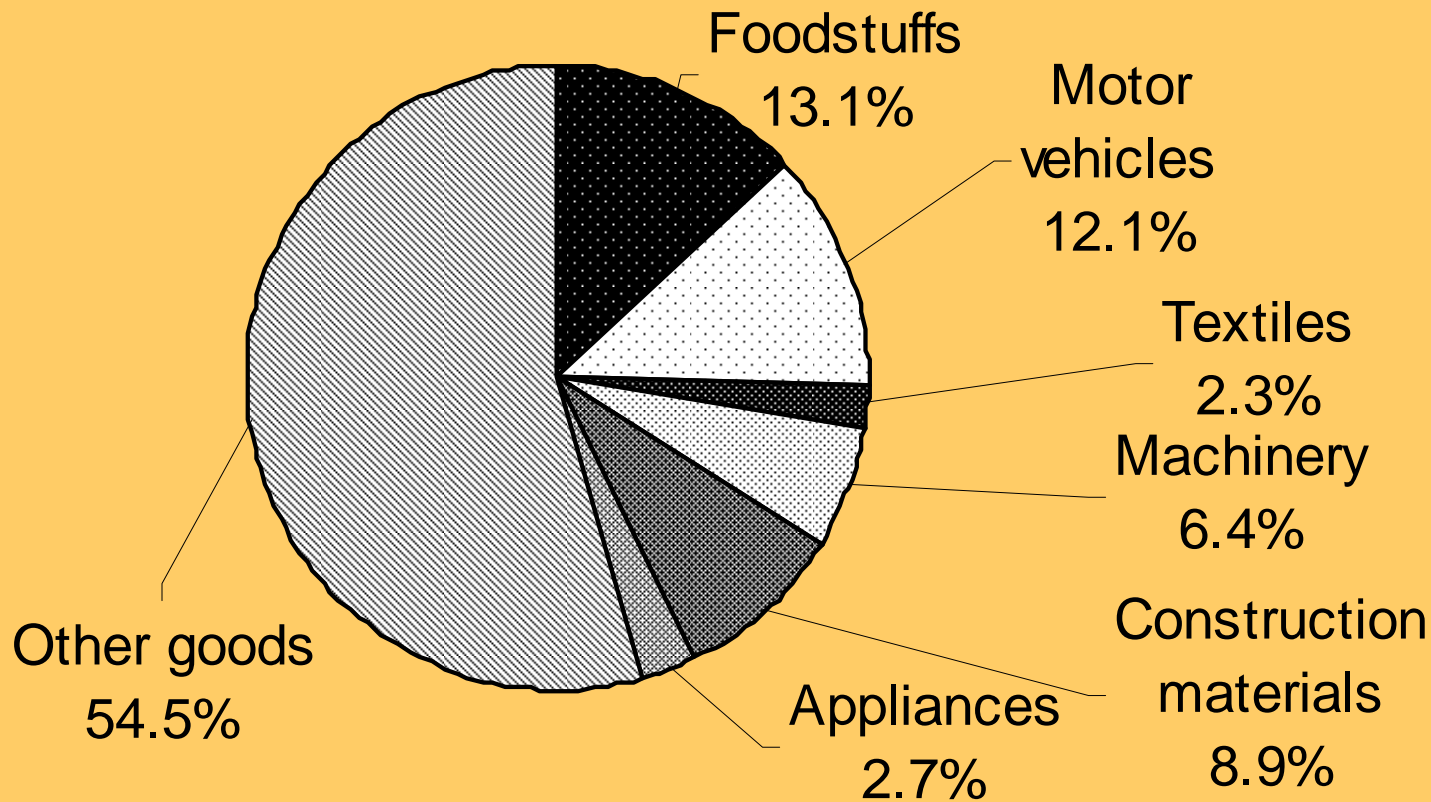


Figure 9.3 Private sector imports financed through commercial banks 2008



Source: SAMA

Despite export diversification the oil sector exports predominates

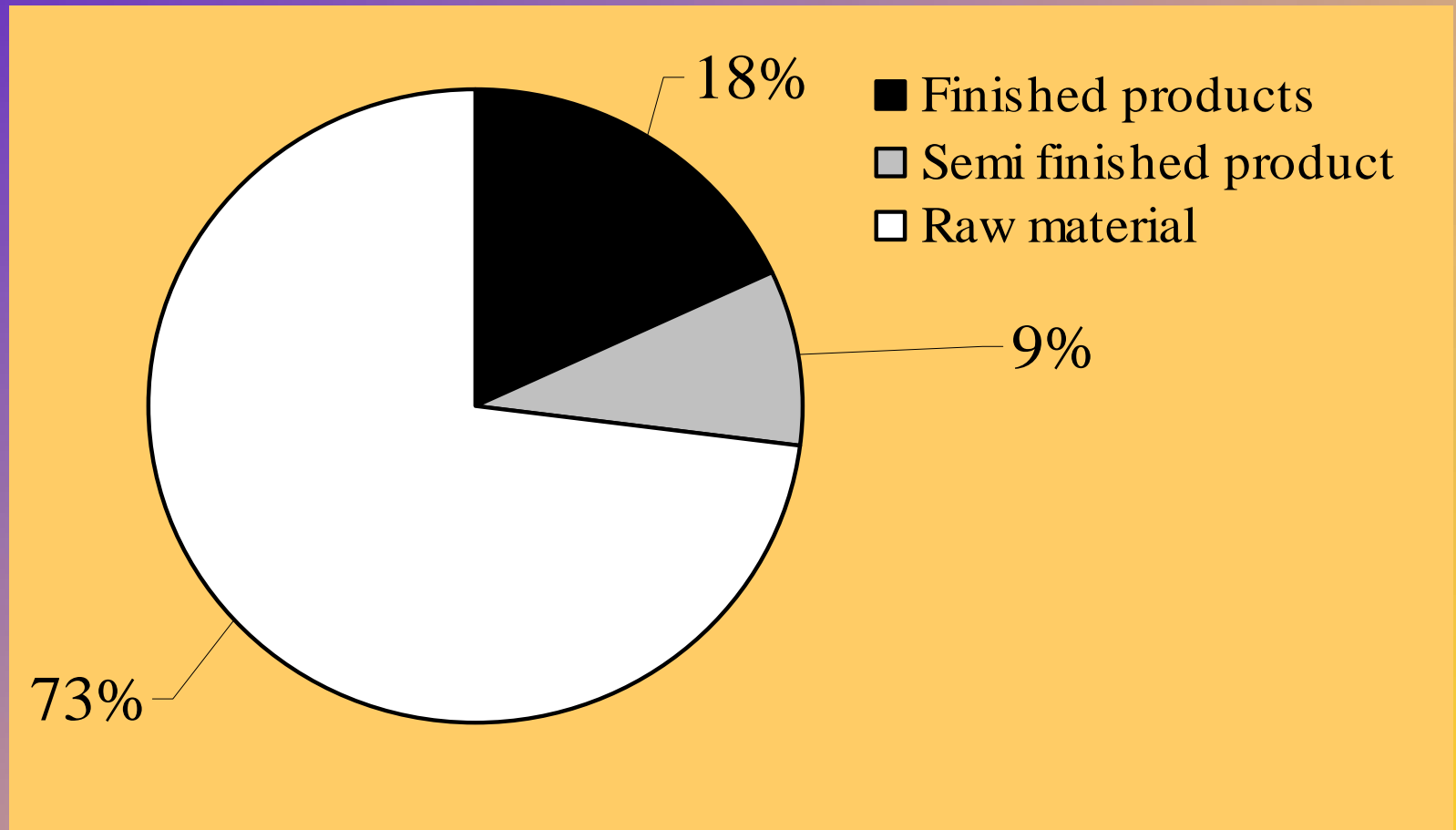
- **Crude oil and oil related petrochemical exports** accounted for around 94% of total Saudi exports in 2008, with little change over the years.
- What has been noticeable is the gradual rise in **refined and petrochemical products as high value-added exports**.
- **Non-oil finished products are also increasing**, as well as semi-finished products, reflecting the maturity of some Saudi manufacturing industries. This is a long term task. For the foreseeable future the Kingdom will continue to be primarily a raw material exporter.

Table 9.8 Oil related merchandise exports 1979-2008 (SR billions)

<i>Export Segment</i>	<i>1979</i>	<i>1984</i>	<i>2005</i>	<i>2008</i>
TOTAL EXPORTS	213.183	132.220	677.144	1,175.354
• Crude petroleum	200.225	127.867	513.939	926.613
• Refined products	0.600	1.750	91.942	127.119
• Petrochemicals	1.939	1.489	42.055	62.464
Oil related Exports	202.764	131.106	647.936	1,116.196

Source: *SAMA*

Figure 9.4 (A) Export by nature of items, 2008



(B) Export by utilization of items (2002)
(SR billion)

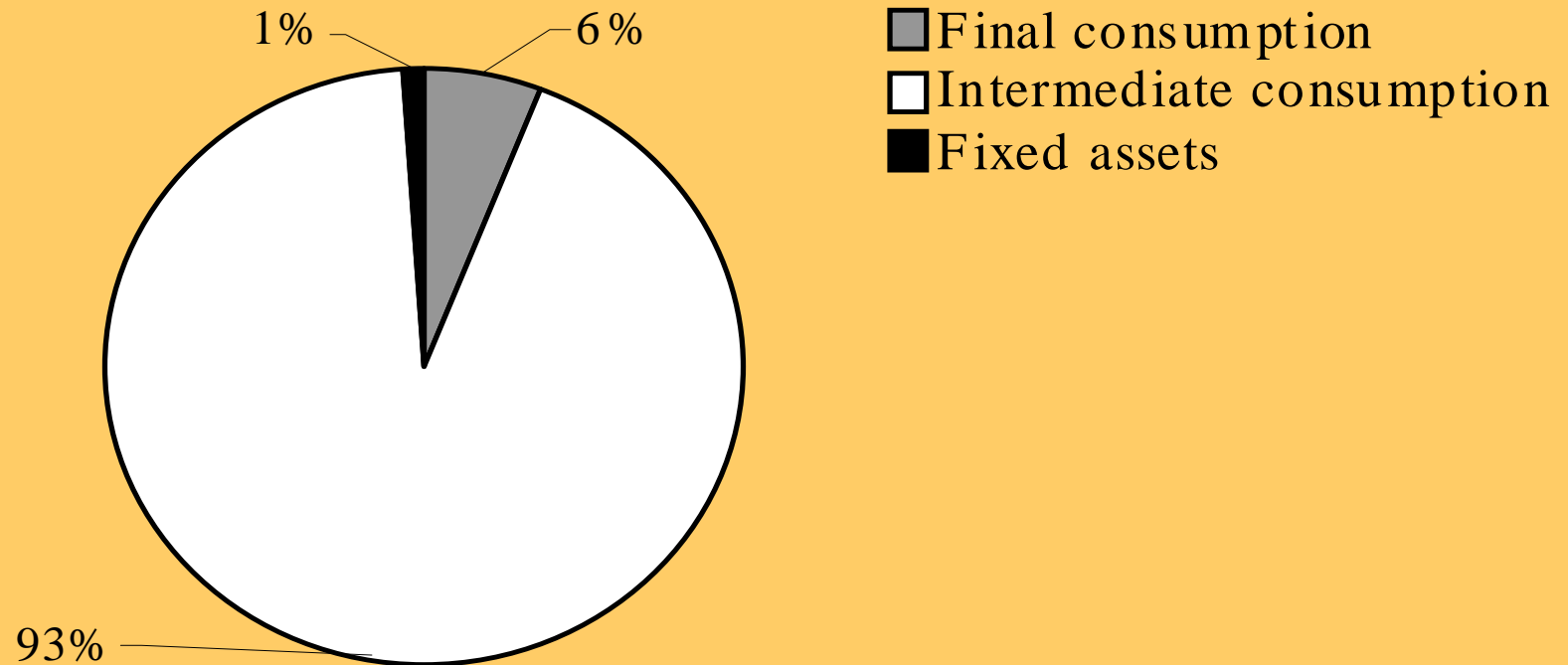
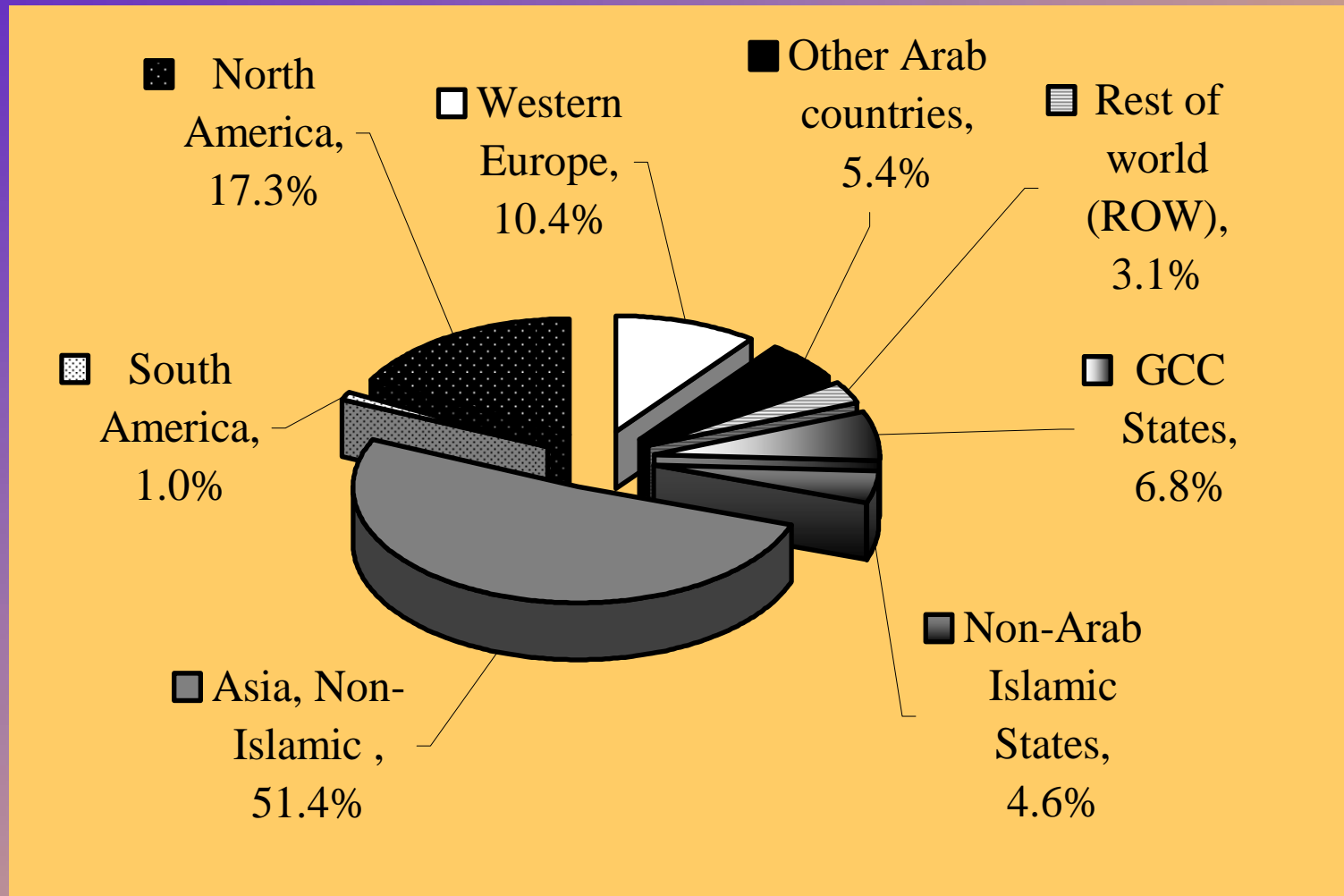


Figure 9.5 Geographic distribution of average Saudi exports 2008



Source: SAMA

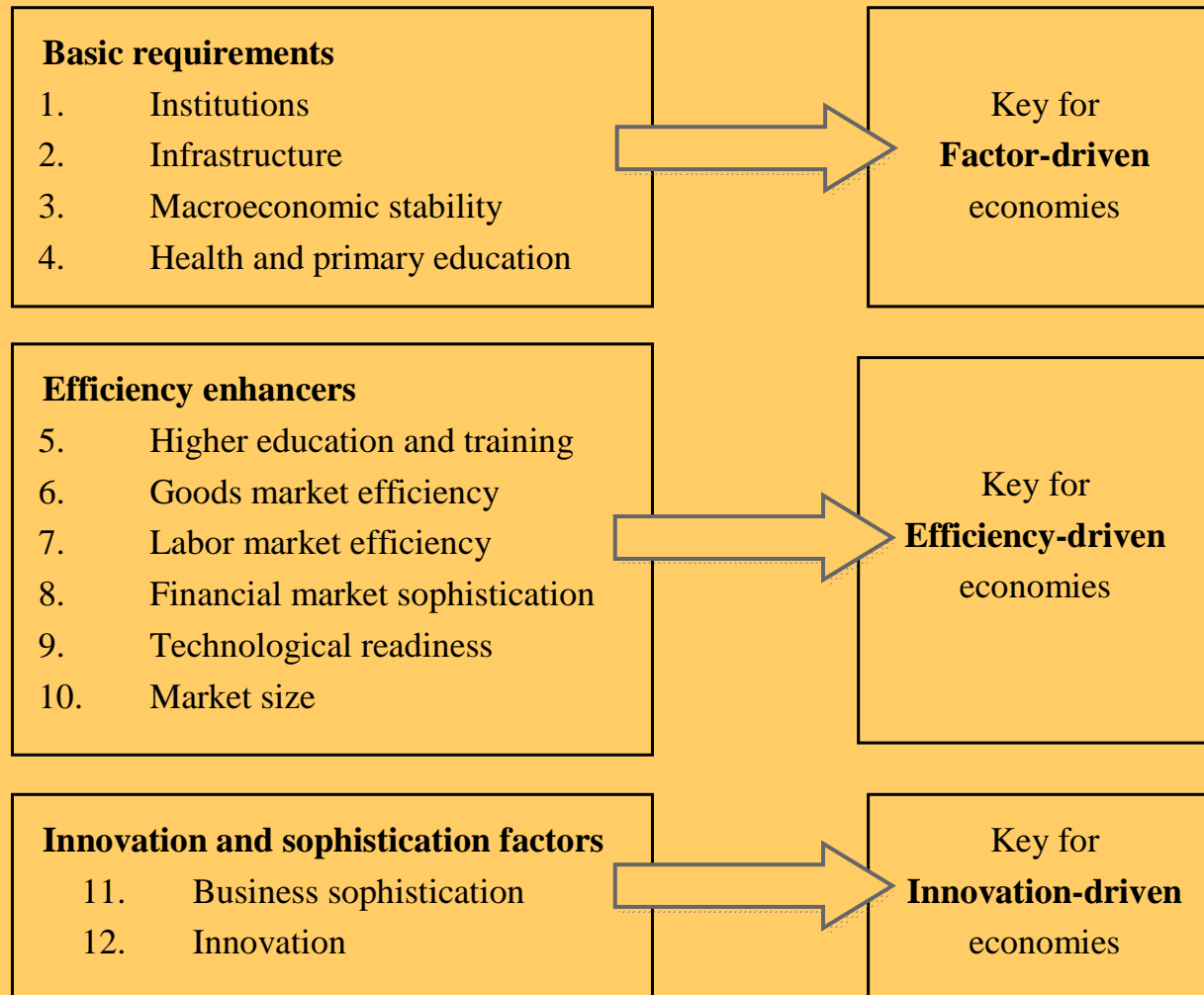
Efficiency and competitiveness are key drivers.

- Over the past decade, the Saudi investment environment and private sector operating framework has benefited from some major **structural and legal reforms**.
- These involved greater liberalization, transparency and reduction of red tape and bureaucracy.
- The result has been a rise in Saudi Arabia's global ranking in **"Ease of Doing Business" World Bank Index** to reach 16th position in 2009 – up from 35th position in 2006.
- This improvement has been largely driven by **SAGIA** which was created to overcome bureaucracy and encourage inward foreign investment.

Competitiveness has many forms

- Nations can be **competitive** based on different abilities derived on being:
 - **Factor – driven competitiveness.** Countries relying heavily on natural resources and basic production.
 - **Investment-driven competitiveness.** Countries try to make production more efficient and enabling the economy to “move-up” the value chain.
 - **Innovation-driven competitiveness.** Countries produce unique goods and services that demand high prices on global markets.
- A nation’s competitiveness depends on its ability to capitalize on these three factors to create raw sources of wealth over time.
- To do this and achieve high competitiveness rankings, countries **have to show superior performance in key macro-economic sectors or “pillars” of competitiveness.**

Figure 9.6. The 12 pillars of competitiveness



Source: *Global Economic Forum (2009)*

Saudi competitive performance

- Saudi Arabia has **steadily improved its world ranking** in both the Ease of Doing Business and also in the **Global Competitiveness Index**, ranking 28th out of 133 countries in 2009.
- According to the 11 pillar classification, the Kingdom scored high in macro-economic stability, goods market efficiency, market size and business sophistication.
- Lower scores were obtained for labor market efficiency, financial market sophistication, and technological readiness.
- In comparison with other economies, such as the OECD and the BRIC's (Brazil, Russia, India and China), Saudi Arabia did relatively well against countries in transition from “factor driven” to “efficiency driven”.

Table 9.9. Global competitiveness index: Saudi Arabia ranking

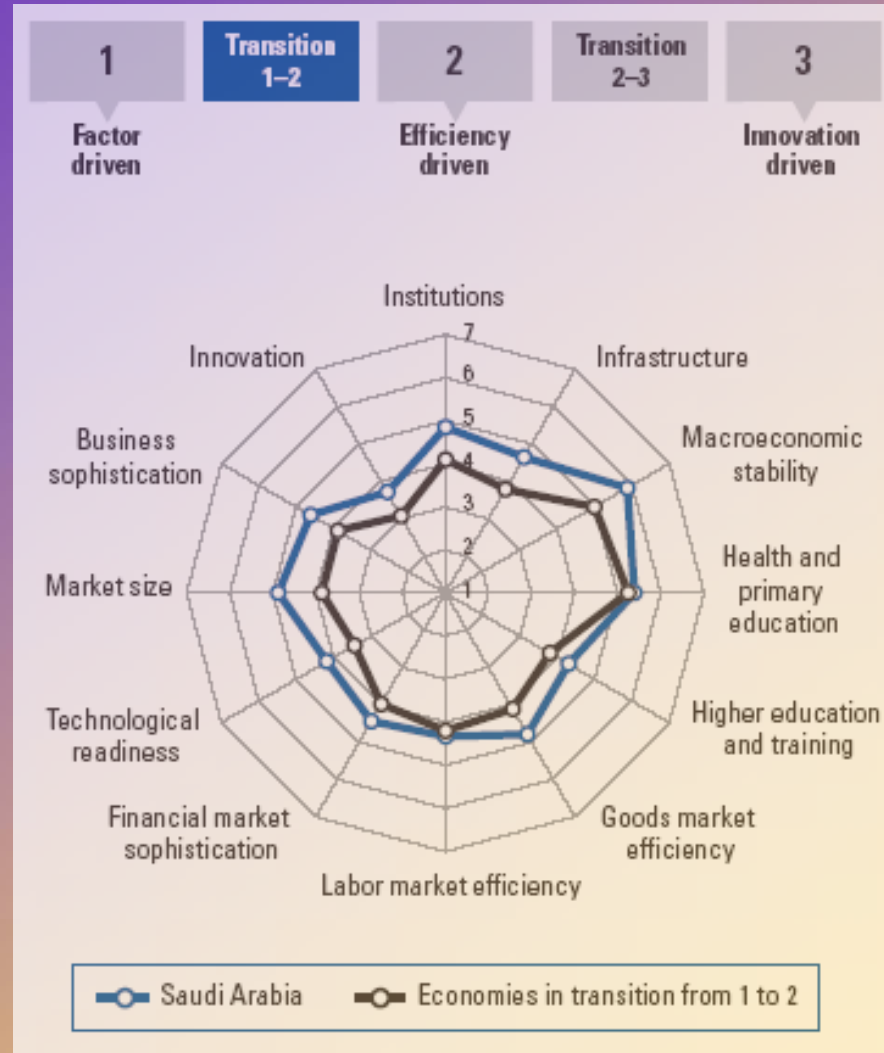
	Rank (out of 133)	Score (1-7)
GCI 2009-2010	28	4.7
Basic requirements	30	5.2
1st pillar: Institutions	28	4.8
2nd pillar: Infrastructure	36	4.6
3rd pillar: Macroeconomic stability	9	5.9
4th pillar: Health and primary education	71	5.4
Efficiency enhancers	38	4.5
5th pillar: Higher education and training	53	4.3
6th pillar: Goods market efficiency	29	4.8
7th pillar: Labor market efficiency	71	4.3
8th pillar: Financial market sophistication	53	4.4
9th pillar: Technological readiness	44	4.2
10th pillar: Market size	22	4.9
Innovation and sophistication factors	33	4.2
11th pillar: Business sophistication	35	4.6
12th pillar: Innovation.	32	3.7

Note: 1: lowest 7: highest score rankings

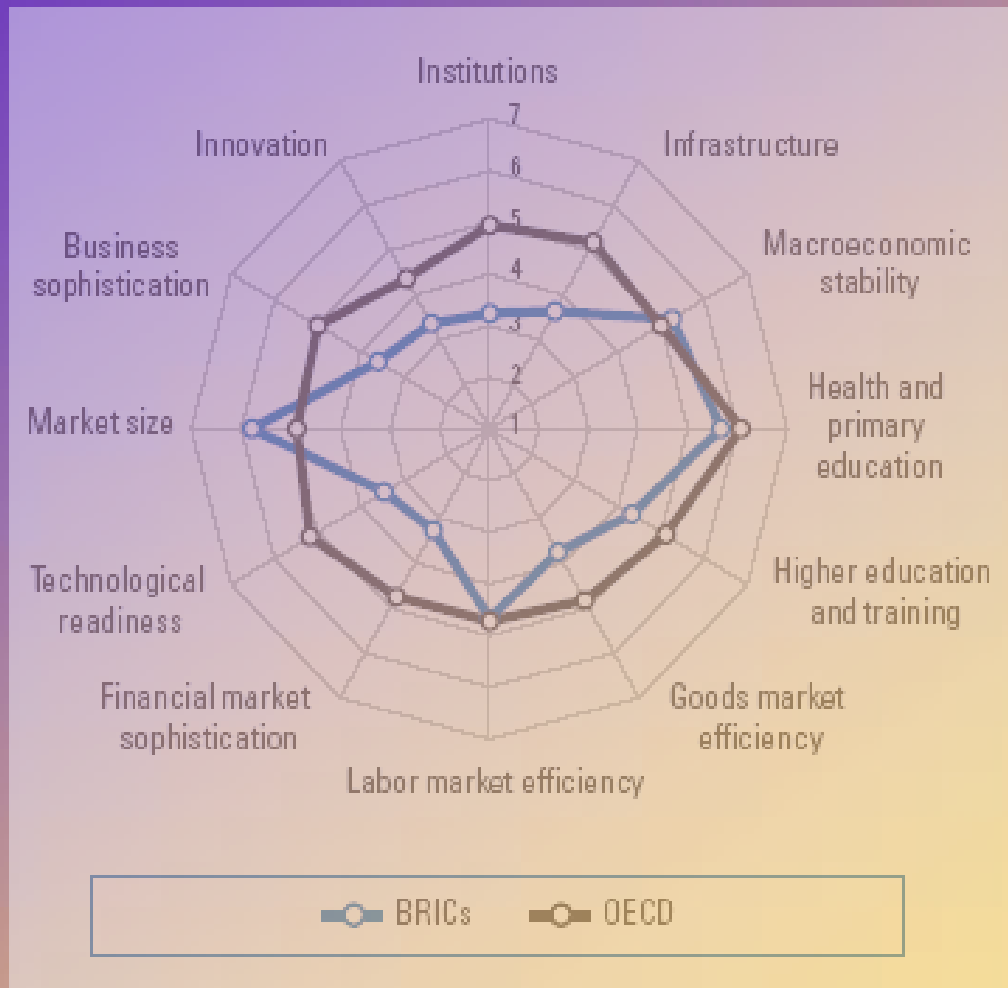
Source: *Global Economic Forum (2009)*

Figure 9.7. Stages of development across 12 pillars of Global Competitiveness Index.

(A) Saudi Arabia



(B) BRIC and OECD average scores



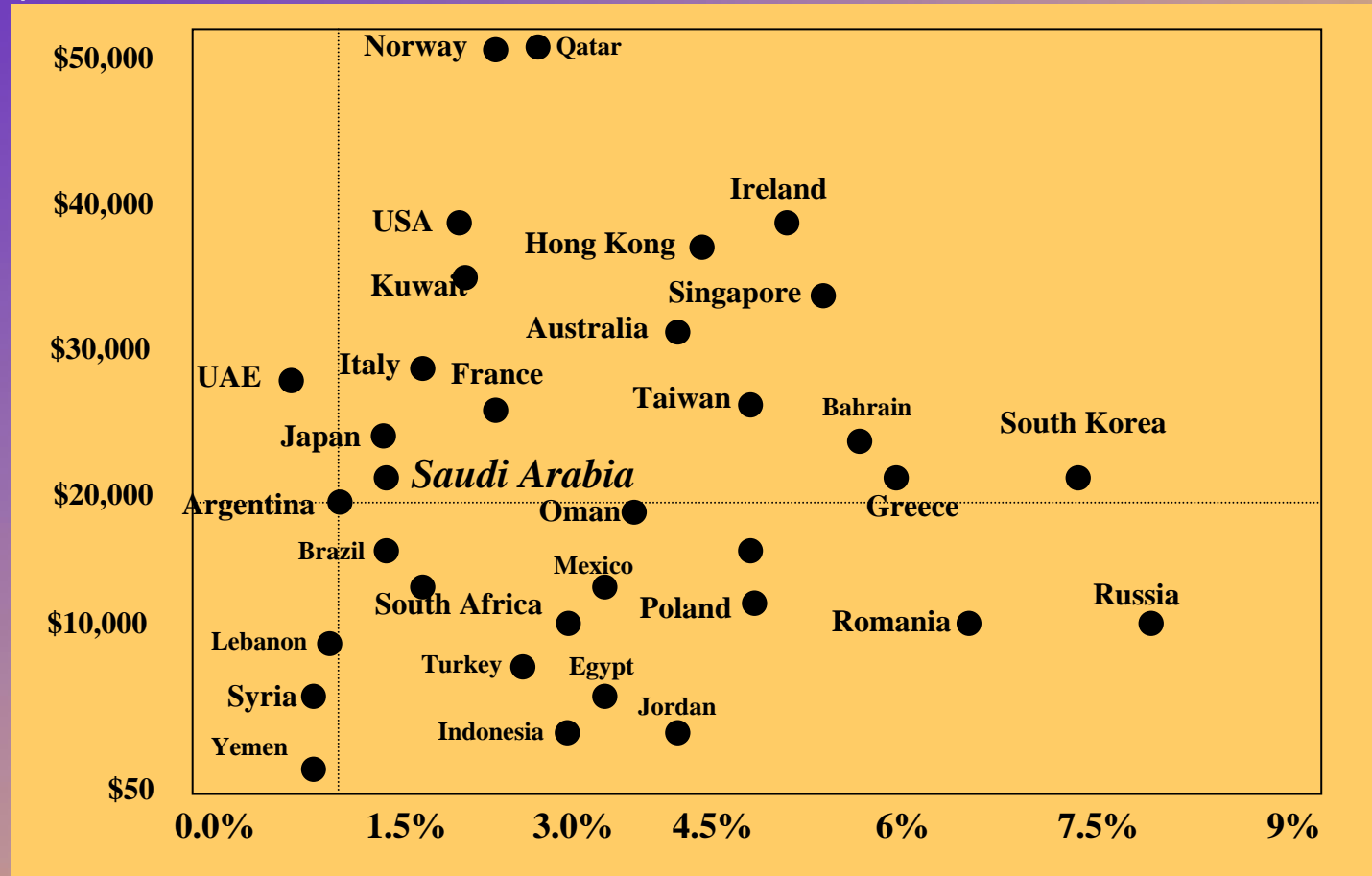
Source: *Global Economic Forum* (2009)

Correlation between prosperity and competitiveness

- Analysis of countries *real GDP growth rates* over the period 1998-2007, revealed a **close correlation** between high real GDP growth and the higher efficiency and innovation driven economies.
- Prosperity is measured in **Purchasing Power Parity (PPP)** adjusted GDP per capita for 2007.
- Saudi Arabia did well against many of the developing countries , even Malaysia, yet was comparatively worse off compared with other GCC countries such as the UAE, Bahrain and Qatar as well as Western innovation-driven economies.

Figure 9.8. Global prosperity performance growth of real GDP per capita adjusted in PPP terms (1998-2007)

*PPP-adjusted GDP
per capita, 2007*



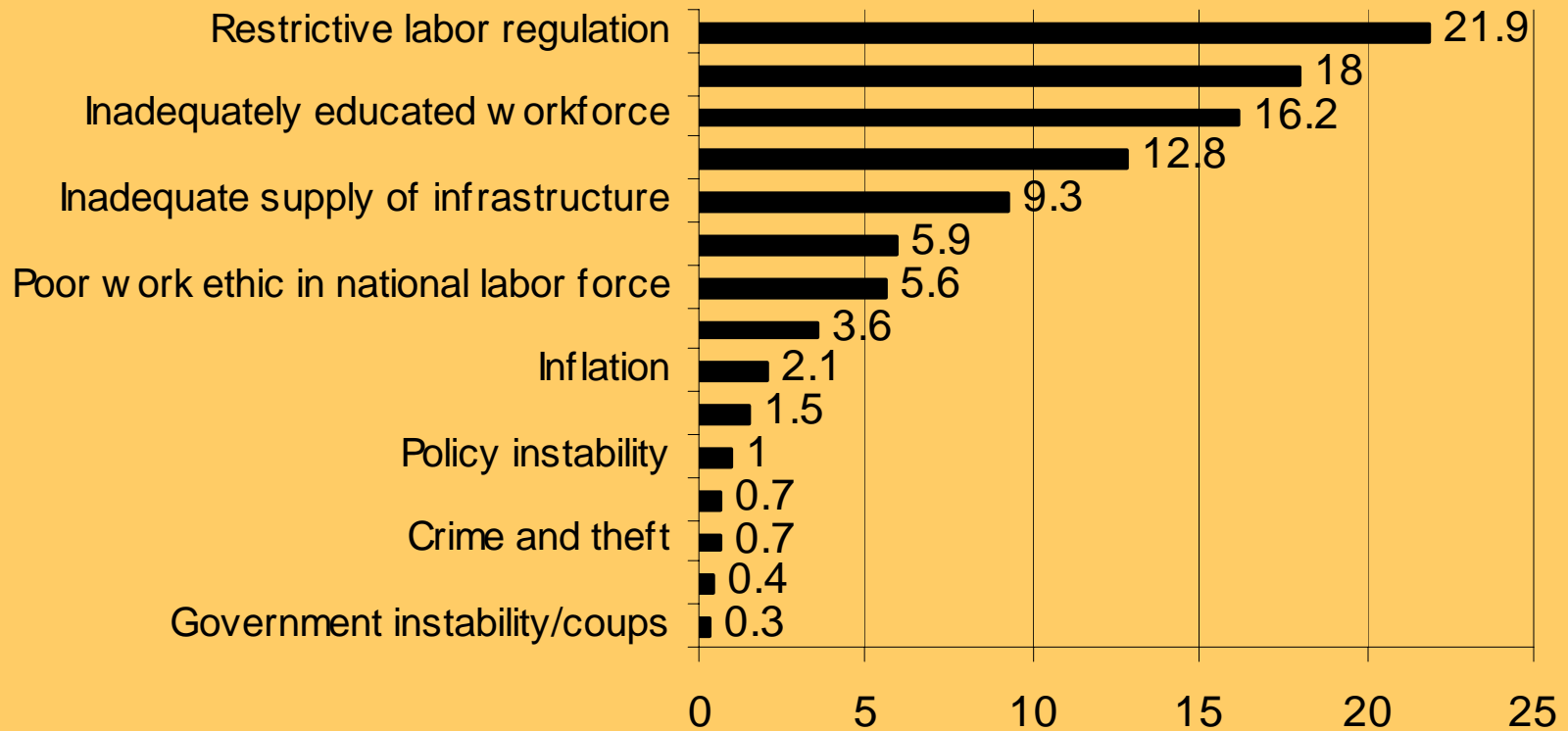
Growth of Real GDP per capita (PPP-adjusted), CAGR, 1998-2007

Source: EIU (2008), Porter, 2010.

Reducing competitiveness obstacles

- Despite progress on many fronts, some **obstacles remain** in achieving higher competitiveness levels in Saudi Arabia.
- One way of **measuring** such obstacles is by **Saudi businessmen ranking perceived obstacles from least problematical to most problematical**.
- The results indicate that **restrictive labor regulations and an inadequately educated workforce ranked high**, while policy instability, crime, theft, and government instability were least problematical.
- These private sector concerns seem to have **mirrored** the country analysis carried out by the World Bank for its “Ease of Doing Business” Index for 2008, although the ease of closing a business and obtaining credit were also ranked as obstacles.

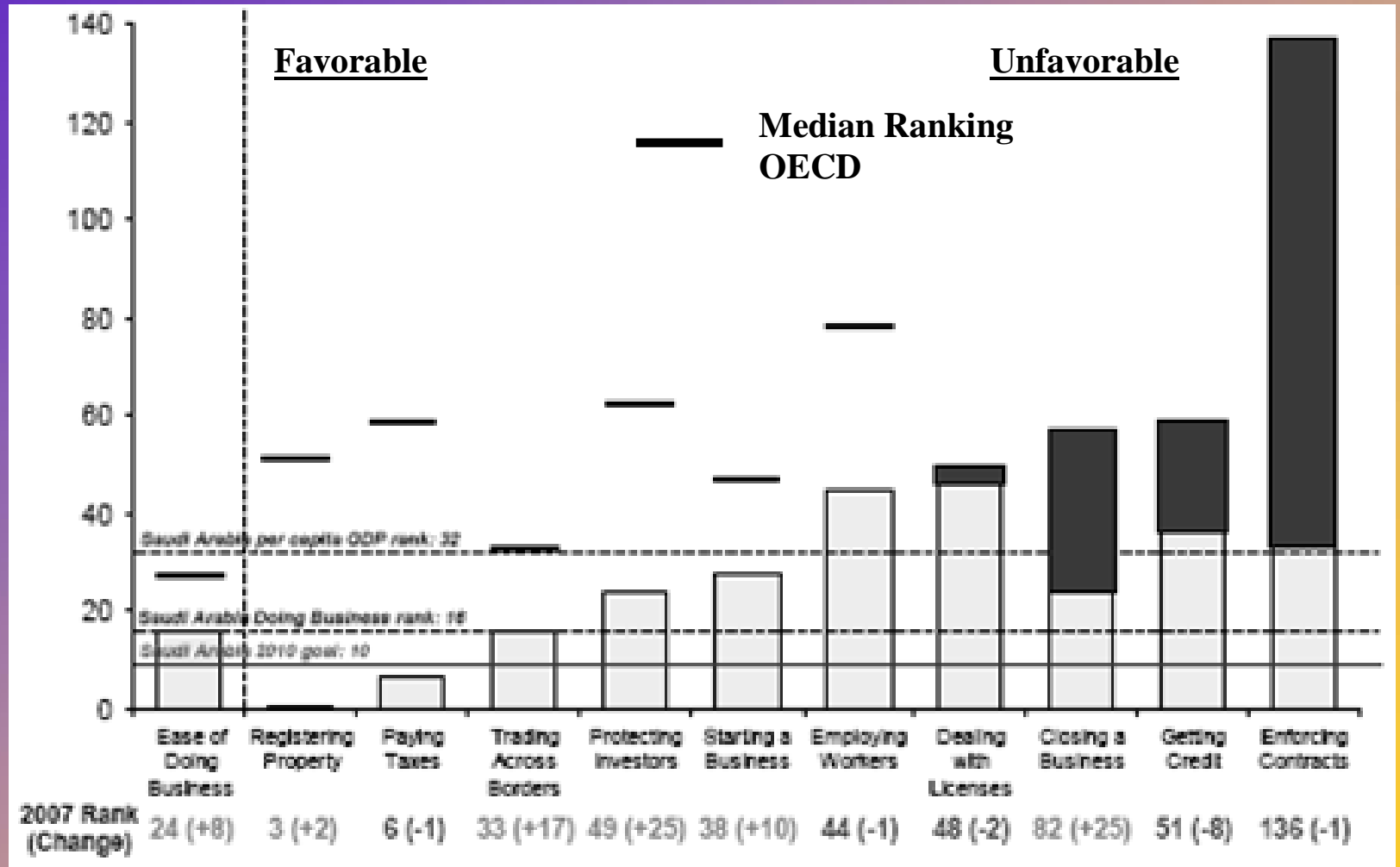
**Figure 9.9. The most problematic factors for doing business:
Saudi respondents (2009)**



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) and 5.(Least problematic). The bars in the figure show the responses weighted according to their rankings.

Source: Global Economic Forum (2009)

Figure 9.10: Saudi Arabia ease of doing business (2008)

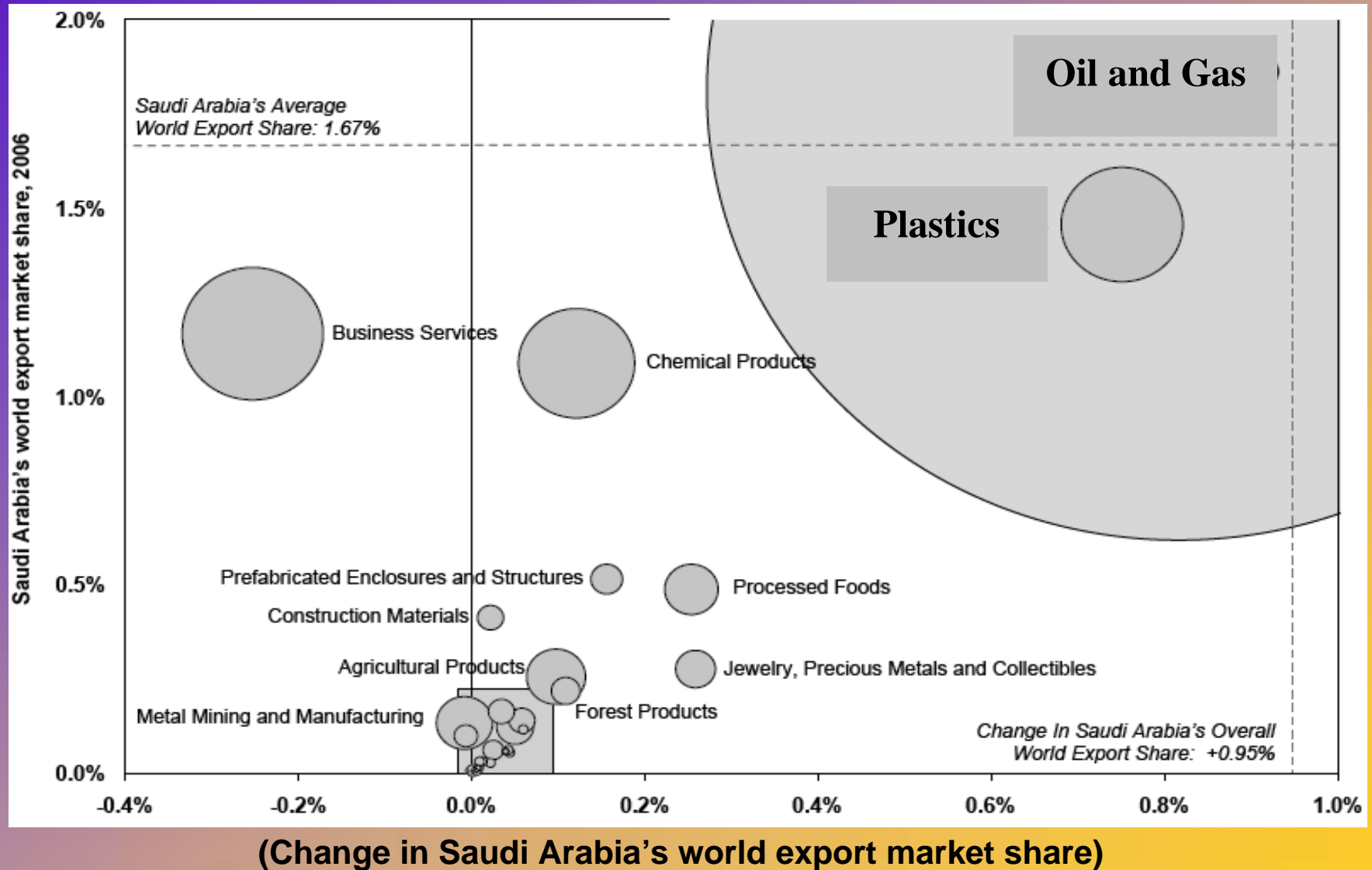


Source: World Bank Report: Doing Business (2008)

Saudi Arabia's competitive advantage

- Saudi Arabia needs to adopt a **new export promotion strategy** that focuses on **efficiency** and **competitiveness**, and which encompasses both oil and non-oil products.
- Analysis of Saudi Arabia's "**champion**" **export cluster** performances indicates that, besides oil and gas, the plastic industry, chemicals, processed foods, prefabricated structures and construction material are the **key drivers** in Saudi Arabia's world export market share increases.

Figure 9.11. Saudi Arabia's "Champion" export cluster portfolios



Source: World Bank Report: Doing Business (2008)

Institutional support is needed

- There are some areas of **institutional support** still needed to make Saudi Arabian exports more competitive as it is firms, **not** nations, that compete.
- **These include:**
 - Direct assistance for exporting firms at each stage of the export process, as exporting is still new to many Saudi firms,
 - Assisting **all** sizes of firms to export, not just large ones,
 - Establishing institutional development programs,
 - Developing international trade in services,
 - Adopting best practices
- Some Saudi companies have risen to the **challenge**. A wide range of products and services are now exported, with many Saudi companies also having an **international presence** to market their products.

Table 9.10 Selected prime Saudi private sector exporting companies

<i>Group</i>	<i>Product range</i>	<i>International presence</i>
Al Babtain	Household appliances	No
Amiantit	Pipes, storage tanks	Yes
Halawani	Food products	No
Al-Qahtani Pipes	Coated pipes, equipment	Yes
Savola Snack Food Co.	Snacks, general confectionary	No
Abdulateef Jameel	Car accessories	Yes
Al Zamil	Air conditioners, steel fabrication, aluminium, plastics	Yes
Arasco	Fertilizers, feedstock	No
Abdulhadi Qahtani Co.	Oil field equipments, machinery	No.
Al Marai	Dairy products	No
Al Rajhi	Foodstuffs, juices, shrimps	No
Bahrawi	Cosmetics, perfumes, food	No.
Al Jomaih	Beverages, cans	No
Nissah	Bottled water	No
Jeraisy	Smart cards, PC equipment	Yes
Fakieh	Poultry, fast food	Yes
Hail Agriculture Dev. Co.	Food product	No
Saudi Cement Co.	Cement	No
Saudi Cable Co.	Cables, electrical wires	Yes
Fitaihi	Jewellery, perfumes	Yes
Savola Group	Ghee, edible oils, foodstuff	Yes

Source: *Top 1000 Saudi Companies, 6th Edition, 2000-2001, IIT, Publishing, Khobar.*

Developing an integrated export promotion program

- Nations do not need to “**invent**” the wheel when it comes to adopting **best practices** in export promotion.
- Saudi Arabia has observed how some nations have become successful internationally and how they keep maintaining a competitive edge.
- Such **models** can be adapted for Saudi Arabia that best suit its **business culture and operating environment** and there is momentum on adopting many of the key elements of various world models.
- The Kingdom has joined the **WTO** and is a member of the Gulf Cooperation Council. It also has bi-lateral trade agreements with many countries. All these represent **opportunities** for trade.

Table 9.11 Saudi Arabia: An export promotion program model

<i>Program</i>	<i>Required Action</i>	<i>Current status</i>
Marketing	Market promotion, strategies, internet marketing, market development	Internet marketing is still not fully developed; market research tends to be product driven rather than customer driven.
Technological	Quality assurance, product and technology development, skills development, information technology, tooling, productivity	Uneven quality assurance and internal R+D development, productivity low
Investment and working capital	Export credits and guarantees, bonded warehouses, marketing finance, seed capital, R+D finance/incentives, export insurance cover	Available but limited in amount and only recently extended to non-oil exports. Limited bonded warehouses, limited R+D finance from commercial banks and government
Collective promotion programs	Research, marketing and trade missions, group promotional programs, comprehensive system of marketing, information collection, global sourcing	Effected through the regional chambers of commerce and industry , some national trade missions; comprehensive data base at national level not yet developed, global sourcing on a pooled basis
Funding and cost sharing	Government funds, 50% cost sharing	Saudi Export credit program exists, using the Saudi Fund for Development (SFD)
Lead agencies	Export promotion authority; export centres, industry associations, and insurance corporation	Export non-payment risk coverage exists through SFD using the French COFACE as partner ; amounts are limited; no national insurance corporation