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## **Saudi Arabia WTO Accession and Global Economic Reforms**

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### **INTRODUCTION**

“There are some of the benefits that Saudi Arabia can expect to reap from membership of the WTO—benefits which will support Saudi Arabia’s effort to invigorate its private sector, diversify its economy and provide more jobs for its growing workforce.”

Supachai Panitchpakdi, WTO Director General

Saudi Arabia has made a strategic decision to join the World Trade Organization (WTO) to benefit from perceived globalization and trade opportunities. WTO accession carries with it both opportunities as well as threats. The impact of global liaison reaches far beyond mere market openness and introduction of measures of international competition. In essence, WTO agreements set to fundamentally transform existing domestic market structures into “real” market systems and to establish Saudi Arabian global trade and production systems that comply with global “rules of the game”. These potential changes have profound implications on government policies, enterprise reorganization, and transformation of the national economy.

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

### **THE NEW GLOBAL ECONOMY: THE PROCESS OF GLOBALIZATION**

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

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

Recent rapid developments in information technology has enabled national organizations to diversify their products and markets with the result that information externalities allow the

globalization movement to go beyond national boundaries towards an integrated “seamless” global trade system, and the growth of “homeless” monies that move electronically around the world at instant speed (Martin, 1999). The globalization of finance has been one of the most dramatic changes occurring since the establishment of the WTO and in effect it has rendered national boundaries largely meaningless (Ohmae, 1990, 1995; O’Brien, 1992; Kobrin, 1997; Budd, 1999).

## **SAUDI ARABIA AND THE WTO**

There is no doubt that Saudi Arabia is one of the largest markets in the world and the largest in the Arab world for many manufactured and service goods. To this end, the kingdom of Saudi Arabia has deemed a strategic decision to join the WTO to enable the country to obtain added benefits of globalization. The working perceived party on the accession of Saudi Arabia was established on July 21, 1993 (WTO Web Site) and today Saudi Arabia stands on the threshold of formal accession, especially following the successful bilateral agreements with the USA in May 2005. Along with Russia and the Ukraine, Saudi Arabia remains the largest economy in the world and the only country of the Gulf Cooperation Council (GCC) that is not a member of the 146 state-trade body.

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

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

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

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

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

- Reducing import tariffs from around 15% to 7% , with further decreases in the future, with a few exception
- “Binding” tariff levels on individual products to a guaranteed ceiling beyond which they cannot be increased
- Phasing out government subsidies to the private sector and agriculture
- Applying non-discriminatory treatment to the goods and services of other WTO members
- Enforcing intellectual property rights
- Guaranteeing “predictable and growing access” to the Kingdom’s markets
- Allowing majority foreign ownership of investment projects
- Treating foreign and local investors equally, which means equal tax treatment, removing the requirement that trade must be conducted through commercial or sponsorship agents (Wakeels) and allowing foreigners to own real estate
- Opening up service sectors such as banking, legal, insurance and capital markets to greater foreign participation

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

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

Saudi Arabia has also insisted that its cultural and religious requirements be respected by its trading partners, particularly with regard to the treatment of goods such as pork and alcohol, the import and sale of which are forbidden in Saudi Arabia. The impact of globalization can be viewed from short and long-term perspectives. Table 1 sets out a brief summary of the potential impact of globalization on the Saudi economy, based on field research for different Saudi business sectors (Ramady, 2005). Table 1 indicates a mixed score sheet of positives and negatives. As far as the private sector was concerned, their major worries centred on the loss of export markets. Of even greater significance was the loss of the lucrative and discriminatory government contracts, for which only Saudi companies could bid, resulting in the institutionalization of local industrial inefficiencies. Some Saudi service and manufacturing enterprises were designed and set up to function in a secure environment protected by high tariffs and monopoly agency agreements.

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

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

**Table 1** Impact of Globalization on Saudi Arabia Economy

Impact	Short-Term Impact	Long-Term Impact
Negative	<ul style="list-style-type: none"> <li>• Encouraging more imports to Saudi Arabia, with balance of payment implications</li> <li>• Weaker local producers under competition strain</li> <li>• Govt. procurement policy giving local priority will be scrapped, making some local firms unable to effectively compete against foreign competition</li> <li>• Export sales may not go up due to quality considerations</li> <li>• Growth in some sectors could slow down, with unemployment consideration</li> <li>• Implementation of international patent laws will have impact on certain sectors, such as pharmaceuticals and chemicals</li> <li>• Less efficient service providers in insurance, banking and telecommunications will be negatively affected by competition</li> </ul>	<ul style="list-style-type: none"> <li>• Questions about the ability of some Saudi industries to meet modernization challenges and adjustment costs</li> <li>• Potential structural unemployment</li> <li>• Exit of some industries due to reduction of subsidies, subsidized loans and tariff protection</li> <li>• Foreign ownership of certain strategically deemed sectors (e.g. Communications)</li> </ul>
Positive	<ul style="list-style-type: none"> <li>• Lower priced imported inputs</li> <li>• Higher multinational investment in local industry with implementation of international patent laws</li> </ul>	<ul style="list-style-type: none"> <li>• Shift from exporting primary products to exporting value-added industrial products</li> <li>• Local firms restructuring</li> <li>• Formation of international strategic alliances with brand name manufacturers</li> <li>• Development of specialized expertise in range of products</li> <li>• Higher multinational investment in local industry with implementation of international patent laws</li> <li>• Wider variety of technology transfers</li> </ul>

Source: Ramady, 2005 (page 340)

## IMPACT OF ACCESSION ON SELECTED SAUDI INDUSTRIES

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

### Petrochemical Industry

Saudi Arabia holds the right of trade and exploration for upstream petroleum production, although joint ventures with foreign companies in gas exploration have been initiated under the Great Gas Initiative Program between Saudi Aramco and foreign companies during 2003-2004. The

petrochemical downstream industry is dominated by the majority owned Saudi Arabian Basic Industries (SABIC), but SABIC also operates joint ventures with foreign owned companies. WTO accession will provide golden opportunities to open up this sector further to restructure and upgrade itself through further cooperation and joint ventures with world leading companies.

The Saudi petrochemical industry is generally competitive in terms of tariffs applied by leading industrialized countries who are already members of WTO. Table 2 sets out petrochemical tariffs applied by the European Union (EU) as well as Saudi Arabia in 2005. The table indicates that Saudi Arabia will not suffer unduly due to WTO entry, but there could be some market loss for those products where the Saudi tariff rates are higher than EU tariffs. However, Saudi Arabia will have several years of grace period to restructure those petrochemical industries which currently enjoy subsidies and high tariff protection.

**Table 2** Petrochemical Tariffs: Saudi and EU Comparison (2005)

	EU	Saudi Arabia
Ethylene Bi Glycol	5.5	6.5
Ethylene	0.0	2.0
Ethylene Glycol	5.5	2.0
Melamine	6.5	6.5
Methyltert. Buthylether (MBTBE)	5.5	2.5
Methanol	5.5	2.5
Propylene	0.0	5.5
Styrene	0.0	0.0
Polyethylene LDPE-LLDPE-HDPE	6.5	9.0
Polystyrene & Poly-vinylchloride (PVC)	6.5	9.0

Source: GOIC, 2002, International Trade Corporation ITC, Geneva, 2005.

According to SABIC, membership of the WTO can be good to the company (SABIC, 2004) resulting in two benefits. First, it will protect SABIC against anti-dumping measures to which non-members have no redress, making life much easier when dealing with WTO members. Second, it will ease the flow of goods and services between countries, making SABIC even more global in nature. However, SABIC is taking no chances even after WTO entry and has embarked on an energetic policy of establishing joint venture operations in major petrochemical-consuming, developed and developing countries.

### Telecommunications

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

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

**Table 3** Telecommunication Competitive Trends: STC and Mobily (June 2005) (SR)

Competitive Factor	STC		Mobily
	Before Mobily Launch	After Mobily Launch	
<b>Prepaid</b>			
<ul style="list-style-type: none"> <li>• Set-up fee</li> <li>• Initial credit</li> <li>• Calling rates</li> </ul>	100 200 1.2	50 200 0.85 (On-Net) 1 (Off-Net)	150 150 0.79 (1 <sup>st</sup> and 2 <sup>nd</sup> minute) 0.69 (3 <sup>rd</sup> minute onwards)
<b>Regular Subscription</b>			
<ul style="list-style-type: none"> <li>• Set-up fee</li> <li>• Monthly fee:</li>   <li>• Calling Rates</li> </ul>	100  60  1. On-net 0.5 (Peak) 0.4 (Off-Peak)  2. Off-net 4.7 (Thuraya) 1.5 (Gold Star)	50  Jawal 35: 35 Jawal 45: 45  1. On-net Jawal 35: 0.45 Jawal 45: 0.35  2. Off-net Jawal 35: 0.50 Jawal 45: 0.50	45  Mobily 25: 40 Mobily 100: 65  1. On-net Mobily 25: 0.43 Mobily 100: 0.43  2. Off-net Mobily 25: 0.37 Mobily 100: 0.37
<b>International (Basic Rates)</b>	Selected Countries	Selected Countries	Selected Countries
	<ul style="list-style-type: none"> <li>• Bahrain: 2.2</li> <li>• Egypt: 3.4</li> <li>• Lebanon: 3.6</li> <li>• U.K: 3.8</li> <li>• U.S: 3</li> </ul>	<ul style="list-style-type: none"> <li>• Bahrain: 2</li> <li>• Egypt: 2.8</li> <li>• Lebanon: 3</li> <li>• U.K: 3.8</li> <li>• U.S: 2.5</li> </ul>	<ul style="list-style-type: none"> <li>• Bahrain: 1.9</li> <li>• Egypt: 2.7</li> <li>• Lebanon: 2.7</li> <li>• U.K: 3.5</li> <li>• U.S: 2.5</li> </ul>

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

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

### Financial Sectors

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

Table 4 indicates the potential growth of the insurance sector following the granting of new licences to foreign companies by the Saudi Arabian Monetary Agency (SAMA) which acts as the supervisory and regulatory authority for this sector. Market estimates believe that insurance

premiums will rise significantly due to government regulations specifying compulsory insurance on drivers as well as medical insurance for private sector employees, both Saudis and expatriates. The latter are estimated to be six million which will give a big boost to the insurance market.

**Table 4** Insurance Market Evolution

	June 2005	Future
<ul style="list-style-type: none"> <li>• Number of Companies</li> <li>• Market Volume (estimation)</li> <li>• % GDP</li> </ul>	<p style="text-align: center;">14</p> <p style="text-align: center;">SR 4 Billion</p> <p style="text-align: center;">Less than 1%</p>	<p style="text-align: center;">22</p> <p style="text-align: center;">SR 15 Billion (2009)</p> <p style="text-align: center;">3-5 %</p>

Source: Arab News, 2005

**SAUDI ARABIA PATH TO ECONOMIC REFORM**

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

First, Saudi Arabia started its reforming before any of its state sectors were in decline, so that heavy subsidies were not needed.

Second, the start of the economic reform and accompanying liberalization of state enterprises in the presence of a large private sector capital surplus, generated domestic growth rapid enough to outpace the speed at which subsidies to state enterprises were increasing.

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

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

**CONCLUSION**

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

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