

# Chapter 7

## **The Private Sector**



## Encouraging the Sector

SABIC's remarkable evolution into a major global chemical company during the troubling times from 1983 to 1995 was a great achievement. Abdulaziz Al-Zamil played a major role in bringing it about. However, as minister of industry and electricity, building and developing SABIC was only one of his responsibilities. Another was to develop Saudi Arabia's private industrial sector.

When Al-Zamil became minister, the situation he confronted was quite different from the one that Al-Gosaibi faced when he had taken the post in 1975. Then, the Saudi government enjoyed enormous budgetary surpluses owing to increased revenue from the sale of oil. Funds coming to government coffers could be invested for the long term in the major new infrastructure projects that have been discussed. These funds could also be invested in SABIC and other businesses, appearing as start-up capital and as loans from the Saudi Industrial Development Fund and the Public Investment Fund.

In 1981, oil prices started to fall, and in 1983, they began to drop precipitously. Expecting prices to rebound, the Saudi government initially maintained its level of investment in industry, drawing from its foreign reserves and from overseas loans. Eventually, however, Saudi leaders realized that the government could not continue to invest as heavily in infrastructure and industrial development as it had over the past decade. This realization became especially acute during the Gulf War, when the Saudi government committed more than \$50 billion to the effort to expel Iraqi forces from Kuwait.

Unable to sustain massive investments in economic growth, the Saudi government looked to the private sector to take up the burden. This expectation was clearly articulated in the Kingdom's Fourth and Fifth National Development Plans, issued in 1985 and 1990, respectively. Importantly, the desire of the government to energize private investment in the economy coincided with Al-Zamil's own vision of his ministerial role. Throughout his tenure as minister of industry and electricity, he would work arduously to engage the private sector in Saudi Arabia's industrialization.

Al-Zamil sought, first of all, to encourage private investment in industry by clearing the obstacles that entrepreneurs might face when starting up a new venture. Reflecting on his approach, Al-Zamil notes,

**My role as minister was to create an environment in which the private sector could be dynamic. With regard to licenses for those who wanted to set up industrial enterprises, the policy during my time was very liberal, not at all restrictive. That was very important. We never tried to second-guess entrepreneurs. When someone came to us and said, “I want to set up a business manufacturing pens,” we never said, “That’s a bad idea. Don’t do it. So-and-so created a business like that, and he failed.” Nor did we say, “Oh, the environment for that is not good.”**

**We understood that if someone is ready to take a risk, he should be free to do so. If he fails, it doesn’t mean the idea for the business was wrong. Maybe he was a bad manager; maybe he had a bad partner; maybe his timing was bad. It is hard to say why he failed. Someone may come along with the same idea for a business and succeed. The people who came to us did not want us to second-guess them, and we wanted them to start a business.**

**That is why we gave private investors the freedom to decide what sort of businesses they wanted to create. After all, they were the ones taking the risk; our job was to issue them a license. Once we issued that license, an entrepreneur could apply for loans and for an industrial site. He could start hiring people and buying raw materials. With our liberal approach, we encouraged the private industrial sector to be dynamic.**

Al-Zamil’s liberal licensing policy encouraged many entrepreneurs to start up manufacturing operations. Initially, these tended to serve the Saudi home market. In due course, however, they also began exporting to overseas markets. One important local industry that evolved into a major exporter was the carpet industry. Surprisingly, the Kingdom had initially been a major importer of carpets. Abdulaziz, reflects on this remarkable transformation:

**I am proud of how the private companies have sprung up in a wide range of areas: petrochemicals, construction materials, food packaging, and so forth. This came about through a gradual**

process. I was reminded of this when I was at a wedding a few months ago, and I met this industrialist whom I had known when I was minister. He was once a major carpet importer. Saudi Arabia was then the fifth largest importer of carpets in the world. At the wedding, we sat next to each other and remembered old times.

He recalled how at some point he decided to take advantage of the opportunities being offered through the Ministry of Industry for aspiring manufacturing entrepreneurs. We provided him with a license and a manufacturing site. He started purchasing filaments and producing carpets. He was successful. His orders started to grow and grow. Then he started worrying about a stable supply of raw materials. He encountered some problems, so he decided to produce his own filaments.

He hired twenty Americans who helped him set up a plant manufacturing filaments in Saudi Arabia. In time, he developed a fully integrated carpet manufacturing operation, and he also gradually became a major exporter of carpets. Six more Saudi manufacturers of carpets came on the scene after him. Saudi Arabia has become a major carpet exporter. This is the outcome of the liberal policy in issuing licenses that I encouraged. Anyone who wanted to start a company and had ability could get a license and manufacturing site.

Some entrepreneurs who had started manufacturing operations urged Al-Zamil not to issue licenses to newcomers, who they saw as future competitors. He never considered that to be an option:

After some time, Saudi Arabia finally had one company producing electric cable, with a very limited output. As a result, electric cables were still being imported to meet growing demand, and Saudi businessmen, seeing a real opportunity, started looking into setting up companies producing electric cables. The man who already had the cable manufacturing operation came to me and said, "I have a license. Don't give one to anyone else."

I had to explain to him, "You received a license because we need companies producing electric cables. I'm not going to prevent others from getting into the business." He and his partners fought

**me, but we went ahead and licensed others. Now Saudi Arabia has a thriving sector producing electric cables. We export them to other countries.**

Al-Zamil strongly opposed efforts to shield Saudi industries with a high tariff wall, the long-term impact of which he believed would undermine the global competitiveness of Saudi products:

**Other countries seek to develop industry behind protective walls. They think that high tariffs allow local manufacturers to be competitive. What you get is the manufacture of a lot of low-quality, noncompetitive goods. We insisted that tariffs be kept at a minimum. Our customs tariffs were among the lowest in the world. As a result, our industries manufacture very high-quality products. When a customer goes into a Saudi supermarket, he cannot differentiate between locally produced and imported products. They are all high-quality products. Our low tariffs created a competitive environment for Saudi industry, and this helped it to become dynamic and, in due course, globally competitive. If you can succeed in the very competitive Saudi market, you can succeed anywhere.**

## Petrochemicals

Early on, Saudi investors sought ways to participate in the petrochemical industry. They saw the profitability of SABIC and were eager to share in its profits. Their eagerness had fueled SABIC's successful IPO in 1984 and Abdulaziz's ability to get private capital involved in SABIC's subsidiaries.

Yet players in the Saudi private sector wanted much more. They sought the opportunity to form major private companies to manufacture petrochemicals from natural gas. However, they had to wait until 1993 before the opportunity arose to do this. It was only then that the Saudi government finally issued clear guidelines governing the formation of private companies planning to receive allocations of low-cost gas feedstock.

The establishment of these guidelines was precipitated to some degree by the attempt of the American Chemical Company (ACC) to set up a major petrochemical operation in Yanbu. The ACC was a joint venture of Mobil and Chemvest—the latter being a Saudi joint-stock company registered in both Saudi Arabia and the United States. In 1991, the joint venture applied to the Saudi Ministry of Commerce for permission to launch an operation and announced its intent to establish a massive methyl-tertiary-butyl-ether complex.

The CEO of Chemvest was the twenty-four-year-old son of the Saudi minister of petroleum and mineral resources, Hisham Nazer. Unsurprisingly, the ACC's application to the Ministry of Commerce attracted a good deal of public attention. In July 1993, the Chemvest-Mobil joint-venture project was rejected by the Ministry of Commerce. Its application was also then reviewed and rejected by the cabinet at a meeting chaired by King Fahd. At that time, the cabinet declared the need for "a clear policy for investments in the petrochemical industry."

To define that policy, the cabinet formed a ministerial committee. Al-Zamil was one of its members. He saw his appointment as an opportunity to advocate for a system that would properly enable the emergence and development of a dynamic private petrochemical industry in the Kingdom.

Joining him in the committee were the ministers of commerce, finance, planning, and petroleum and minerals. After considerable discussion, the committee decided that private petrochemical companies would need to meet three criteria before they could be registered and receive an allocation of gas feedstock: they should be public joint-stock companies involving a large number of investors; they should have a strong financial base; and they should include in their product slate one or two chemicals that are not already being produced in Saudi Arabia. Ever since, these guidelines have shaped the evolution of the Saudi private petrochemical industry, enabling it to flourish. They have also ensured total transparency in the formation of private petrochemical ventures.

Following the committee's decision, a four-step process for forming a petrochemical enterprise emerged: first, a company receives an initial license from the Ministry of Industry and Electricity; second, it obtains a feedstock allocation from the Ministry of Petroleum and Minerals—in practice, the

allocation comes from Aramco; third, it secures a final license from the Ministry of Industry and Electricity; and last, it obtains permission to form a company and registers with the Ministry of Commerce. Al-Zamil was at the forefront advocating the establishment of this clear set of regulations. Within the cabinet and within the ministerial committee, he strongly and consistently argued for a system that would allow low-cost gas feedstock to be allocated to private companies. A long-time associate, Fahad Al-Rajhi points out,

**It was fortunate that Abdulaziz was minister in 1993. He supported the idea of allocating natural gas feedstock to private companies, paving the way for private investment in the petrochemical sector. He persuaded the king and other ministers to his point of view. He worked hard to accomplish this. It was not easy. Because of his effort, the foundation was laid for today's flourishing private petrochemical industry. It was largely through his efforts that private chemical firms could finally get industrial sites and access to gas feedstock. Al-Zamil is truly one of the founders of the industry in Saudi Arabia. He also played an important role in encouraging downstream industries. Together, these are all important contributions to the industrialization of the Kingdom.**

Al-Zamil's brother, Abdulrahman Al-Zamil, echoes this view:

**Providing gas feedstock to the Saudi private sector made history. It could not have happened without Abdulaziz being there. He knew and understood the private sector. This enabled him to advocate effectively for regulatory measures that permitted a private petrochemical industry to emerge and flower.**

The price of feedstock offered to private chemical companies was quite advantageous, as Al-Zamil notes:

**For dry gas, it was seventy-five cents per million BTUs; for liquid gas, it was the world price, based on the price of naphtha in Japan, minus 28 percent. This made Saudi Arabia one of the most cost-advantaged places in the world to produce petrochemicals.**

**It was a move intended to allow new chemical players into the game. By this pricing scheme, we signaled that the private sector**

**was welcome to participate in petrochemical manufacturing: in fact, the government was encouraging the private sector to go into petrochemicals. Up to then, SABIC had been the only Saudi company receiving gas feedstock allocations; now it was joined by a number of private companies.**

A wave of proposed aromatics and methyl-tertiary-butyl-ether projects swept in. However, the long-term impact of the policy that Al-Zamil had fought for would emerge only after he left office in 1995. It was then, and in the following years, that a host of major private petrochemical companies, based on gas feedstock allocations, built and started up large manufacturing operations. Leading the way were Saudi Chevron, NAMA Chemicals, and Teldene.

## Downstream Industries

With regard to Saudi industries that are downstream in the petrochemical value chain, there were some thorny issues that Al-Zamil needed to address. In his dual role as minister of industry and electricity and chairman of SABIC, he wanted SABIC to maximize its profits, and at the same time, he needed to encourage the development of private companies that depended on SABIC for feedstock. These included firms producing plastic products and intermediate chemicals.

The complaint of Saudi customers of SABIC was very simple. They pointed out that SABIC was paying a very low price for the feedstock it received from the Saudi government, but this cost advantage was not being passed on to domestic customers, who were paying the global market price. For many, this seemed unfair. They wanted SABIC to offer them a big discount.

SABIC, on the other hand, was quite reluctant to offer such discounts to its Saudi customers. First of all, to do so was not regarded as good business practice. It would hurt SABIC's bottom line, which would be unfair to SABIC's shareholders. Second, offering such large discounts could cause problems with overseas customers competing with Saudi producers. Given that SABIC depended strongly on export markets, this was an important

concern. Al-Zamil needed to find concessions that would mollify Saudi customers but not undermine SABIC's profitability or cause an outcry abroad:

**I tried to impress those at SABIC about the need to develop domestic and regional customers. Properly cultivated, such customers could be responsible for 20 percent of SABIC's sales. The potential was there. It was in SABIC's interest to adopt pricing practices that took account of local customers and their proximity to SABIC's production sites. It made sense to offer nearby customers lower prices because SABIC's costs in terms of logistics and so forth would be lower.**

**More important, SABIC needed to realize that local customers are more likely to become long-term customers. The guy in Singapore may buy from you today and from someone else tomorrow, but the local customer can easily be converted into a reliable client who always turns to SABIC first. That is why I encouraged SABIC to provide domestic and regional customers with certain advantages.**

As a result, SABIC offered special considerations for domestic and regional customers. These consisted of a quantity discount, freight charges subtracted from the price, more favorable open account terms, and the promise to fulfill the orders of domestic and regional customers first, in the event that demand for a product exceeded supply. Al-Zamil notes,

**These modest concessions have helped alleviate the situation, but all issues have not been resolved. Customers in Saudi Arabia still complain that they do not benefit from the low price that SABIC pays for its feedstock. Of course, SABIC needs to ensure its profitability, and customers also want their businesses to be more profitable. We can expect SABIC's pricing to be an issue into the future. Another demand of local customers is that SABIC make a long-term commitment to supply ethylene and propylene. Let's say for ten years. SABIC can commit to a one-year supply but has been unwilling to commit to longer periods. Clearly, local producers want to have that stability as they plan their future. These are issues that may never be resolved.**

## Measures of Growth

Much to Al-Zamil's delight, private industrial activity grew steadily from 1983 to 1995:

**Seeing that dynamism while I was minister gave me a lot of satisfaction. I would go around and see how full of life the private sector was becoming. There was a growing food industry and pharmaceutical industry. I very much enjoyed visiting industrial estates and seeing them grow. When we first started, we were begging people, "Come in. Establish a business." By the time I stepped down as minister, a steady stream of aspiring entrepreneurs was coming to us.**

While Al-Zamil was minister of industry and electricity, the role of the Saudi private sector expanded, helping to make up for reduced government investment in industry. By fostering a regulatory environment that encouraged and enabled the private sector to launch new enterprises, to partner with foreign firms in dynamic joint ventures, and to invest in capital-intensive technology, Al-Zamil helped make the private sector an engine for economic growth and diversification. His vision and leadership were crucial to the process of putting greater responsibility for economic development on the private sector.

Al-Zamil's success is manifested in the growing number of private-sector companies that appeared during his tenure as minister. Success is also demonstrated by the greater volume of private capital investment. By the end of his term, the private sector's contribution to gross domestic product (GDP) had increased to 45 percent, with manufacturing alone constituting 8 percent of the contribution.

The growing number of private enterprises shown in Tables 1 and 2 bear witness to the impact of Abdulaziz Al-Zamil's tenure as minister.

**Table 1: Number of Private-Sector Establishments by Year\***

Year	Number
1987	11,926
1988	11,970
1989	12,046
1990	12,006
1991	12,131
1992	14,269
1993	15,487
1994	16,508
1995	17,234
1996	17,972

\*See KSA General Organization for Social Insurance (1974–1986) Annual Statistics Reports.

**Table 2: Number of Private Manufacturing Establishments\***

Year	Number of Factories	Total Investment (USD millions)	Total Employees
1983	1,196	18,842	133,368
1985	1,401	34,095	155,567
1987	1,583	35,456	168,010
1989	1,800	40,019	183,011
1991	2,000	36,751	172,848
1993	2,234	40,325	196,022
1996	2,598	50,846	240,031

\*See: Achievements of the Development Plans (Facts and Figures, 1970–2014), p. 285.

From 1985 to 1995, the private manufacturing sector increased its contribution to the Saudi GDP, as is made clear in Table 3. Total Saudi GDP grew 40 percent, from SR 404 billion (U.S. \$110 billion) in 1985 to SR 567

billion SR (U.S. \$153 billion) in 1996. At the same time, petrochemicals grew as a fraction of GDP.

**Table 3: Contribution to GDP of Manufacturing (in billions SR)\***

Year	1985	1995
Petroleum Refining	13.8	13.5
Petrochemical	0.5	3
Other	13.1	14.6

\*Compiled from the Fifth and Sixth National Development Plans.

Also impressive is the important contribution of the private sector to fixed capital formation, through land improvement, purchase of machinery, and so forth. Table 4 shows how during Al-Zamil's term as minister, the private sector contributed dynamically to the development of Saudi society.

**Table 4 : Contribution of the Private Sector to Fixed Capital Formation\***

Year	In Millions USD	Percentage of National Total
1987	8,279	47.62
1988	8,438	55.59
1989	8,690	53.95
1990	7,487	37.54
1991	9,814	42.54
1992	14,583	58.19
1993	16,112	61.37
1994	13,890	61.85
1995	14,298	57.31
1996	21,706	79.14

\*See Tim Niblock et al., *The Political Economy of Saudi Arabia* (New York: Routledge, 2007), p. 86.

As Table 5 demonstrates, the number of employees in manufacturing grew despite the downturn in the national economy during much of the 1980s and the 1990s. This was especially the case with the private manufacturing enterprises that Al-Zamil was encouraging, which are labeled in the table as "Other." When Al-Zamil stepped down as minister of industry and

electricity, there were over 350 foreign joint ventures in operation in Saudi Arabia, bringing technology and employment to the nation. This represented a capital investment of SR 80 billion (U.S. \$22 billion).

**Table 5: Persons Employed in Manufacturing\***

Year	1985	1990	1995
Petroleum Refining	14,000	14,600	16,800
Petrochemical	4,700	6,200	8,000
Other Manufacturing	405,000	473,000	542,000

\*See Fifth and Sixth National Development Plans.

These various measures display some of the important ways in which Abdulaziz Al-Zamil helped foster the development of the Saudi economy in his role as minister.

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