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Original Article

Expected impact of privatization on economic growth in Saudi Arabia within the framework of the National Transition Plan to accomplish the Vision 2030

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I. INTRODUCTION

Privatization is considered a means to change the structure of the economy, the role of private enterprises and increase competition. The importance of privatization is based on diversifying the economy to reinforce the role of the private sector and raising economic efficiency. Therefore the process of privatization can lead to economic growth if it improves the saving rate, efficiency, and technical progress. In conjunction with the objectives of Vision 2030, especially those related to the expansion of privatization of government services to achieve balance in the budget and to improve the level of performance, productivity and flexibility of government agencies and create an attractive environment for local and international investors and increase their confidence in the Saudi economy, many government agencies have set several strategic goals that represent the main challenge.

The subject of privatization caused a lot of debate and controversy. This subject does not represent an economic theory standing as a whole, but it is always discussed around the role of the private sector and the efficiency of the Market Economy System, based on the forces of supply and demand within economic freedom**,** in relation to the social interactions and the interest conflicts between social classes.

In section I, we present several privatization theory analyses. In section II, we discuss some controversial empirical results. Section III reveals the process of privatization in Saudi Arabia (in the area of Vision 2030Realization Program (VPR)) and the risks and opportunities associated.

II. THEORETICAL FRAMEWORK

Some privatization theories are based on the fact that public companies are unproductive because of their high exchange costs and interest conflict. Moral hazard and adverse selection are less probable in private companies because of corruption control and managers rousing (Cuervo and Villalonga, 2000). Literature on privatization theory could be studied around three theoretical and political economy views: Marxian, institutionalist and Keynesian, and neoclassical(Zaifer, 2017):

Marxian political economy approaches have understood privatization as more than the simple sale of public enterprises to the private sector. In this view, Marxists presume privatization to restore the power of capital at the expense of labouring classes, and there is an inherent conflict between workers and capitalists. Markets are understood within a wide-ranging arrangement of the capitalist economy and social relations of power (Therborn 1976, 108-113). The working class produces the social product but has only the sale of its labour-power to receive its means of subsistence (Albo, 2005).

Institutionalism and Keynesianism tend to defend a balance between economic efficiency and social development, between state ownership and privatization[1]. Institutionalists and Keynesians tend to retain that Privatization can only lead to economic and social development in countries with stable macroeconomics political contexts and strong governing and institutional structures[2]. This literature lays more importance on institutional environment and extra-market organization in the rationalization of privatization.

The predominant theory of privatization is in the area of neoclassical theory, which defends the market economy. At that point, According to Property rights theory, Public choice theory, and

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2)see for exampleWeizsackeret al (2005); Gupta (2000) ; Parker and Saal(2003); Rowthorn and Chang (1993).

3) see for example Yarrow (1989); Gupta (2000); Bortolotti and Perotti (2007).

Principal-agent theory, the central theoretical hypothesis of privatization is that the free forces of the market raise the efficiency of investment. Property rights theory adopts that people look for the best allocation of resources, and due to a shortage of motivation, managers of public companies have managerial efficiency lower than that of private organizations (Megginson, 2005). Agency theories assume that managers perform better in private companies than in public companies: Private firms have clear objectives, so it is easier for their owners to look over managers' performance (Dharwadkar et al., 2000). For the Public Choice Theory, it is presumed that individuals seek rational maximization of desirability in the market and in the policy (Hodge, 2000).

As stated by neoclassical and liberal political economy, the rise of privatization policy is the solution to state failure (Megginson and Netter 2001). this approach provides absolute support to privatization. The pro-privatization arguments adopt that there are many economic benefits of the process of privatization. We present below a small number of:

- Through privatization, reducing the size of the government will improve efficiency. Individuals become more interested and invest in their property since they are directly recompensed for their determinations.
- Since government corruption can play a negative role in economic growth, privatization is important (Easterly, 2001). It changes the focus from party-political goals to economic intents (Poole, 1996).
- Privatization can have a positive effect on a country’s fiscal situation: By reducing the size of the public sector, the government reduces total spending. This process can help to break a vicious cycle of borrowing and incessant increase of the state debt (Poole, 1996).
- Privatization leads to an increase in foreign direct investment, which has positive spillovers of technology, well management skills, and access to international production systems.
- Privatization can also reduce capital outflows, diversify the economy, and provide more job opportunities.

More recently, the endogenous growth theory advocates that, in the presence of externalities, the distinction between the competitive and the optimal equilibrium paves the way for the economic policy that could aim to increase public and private capital accumulation to achieve a higher growth rate. Investment is a source of "learning by doing" that improves productivity not only of the investing company but furthermore the other companies benefit inevitably from this additional investment in the economy. Romer (1990) concluded that the accumulation of technical knowledge is the engine of economic growth and that the economy which allocates large proportions of capital to research achieves high growth over the long run. The main growth factors presented by endogenous growth theories have a common feature: they generate positive externalities. These externalities and spillover are an inherent result of investment and entrepreneurship.

The central implication of this slender comparative analysis of the general theoretical literature on privatization is that conceptual studies of privatization had different logics, assumptions and methodologies, which led inevitably to different choices about privatization policy. The empirical studies improve this controversy moreover:

III. Some controversial empirical studies

As seen above, there is not a lucid theoretical framework to guide empirical work on privatization and growth, and current models do not completely specify the variables that should be apprehended constant while guiding statistical inference on this relationship. This has produced diverse empirical literature, in which few studies control for the variables considered by others[3].

By studying the effects of Privatization on Economic Growth in the MENA Countries over the Period 1999-2014, Masomehand Maryam(2015)found that the impact of the private sector on economic growth has been negative. They specify that this may be due to a lack of reform in rules and institutions. It should also be noted that the effect has no significant impact on economic growth, indicating the lack of an appropriate place for the private sector in the MENA countries.

In a study titled 'Investigating the Effects of Privatization on the Economic Growth in Developing Countries: A Fixed Effects Approach', Farhad et al (2012), show that privatization in sub-Saharan Africa, MENA region, and Latin America and Caribbean region, had no significant effects on economic growth (Similar results of the previous research), but had significant positive effects on economic growth for Western Europe, South Asia, West Asia and Pacific areas, and Central Asia. Adnan Filipovic (2005) confirms that the process of privatization can be an effective way to achieve fundamental structural change by reinforcing property rights, which directly create strong

[4]According to Levin and Renelt (1992), more than 50 variables are found in at least one regression that are significantly correlated with the economic growth.

individual incentives. He confirms that while privatization is intended to promote economic growth, it will not be the magical solution to the subtle quest for growth.

IV. An empirical framework

The founding model of the new growth theory (Romer [1986]) was built on the existence of external technological factors between companies as a result of the accumulation of physical capital. The positive externalities arise because the knowledge resulting from the investment and production could not be entirely preserved by the company that produced it. This was analytically attested through Romer's model established to show the possibility of endogenous growth in the presence of positive externalities engendered by physical capital accumulation:

In an economy of N similar company, it K_j is the level of the physical capital of the company j, and $\overline{K}=\sum_{j=1}^{N} K_j$ The accumulated stock of capital of the whole economy, the production of one company follows not only his level of physical capital but also is affected by the macroeconomic stock of capital, $\overline{K}=\sum_{j=1}^{N} K_j$.

$$Y_j = F(K_j, \overline{K})$$

If we take the following form of the production function

$$Y_j = F(K_j, \overline{K}) = K_j^{\alpha} \overline{K}^{\beta}$$

$$\alpha + \beta = 1$$

Assuming that all companies are similar and the rate of saving (s) is constant, we get net investment as follows: [4]

$$\dot{K}_j = sY_j = sK_j^{\alpha}\overline{K}^{\beta} = sK_j^{\alpha+\beta}\ N^{\beta} \qquad \Rightarrow$$

$$\gamma_{K_j} = \frac{\dot{K}_j}{K_j} = \gamma_Y = sN^{\beta}$$

The output growth rate of this representative company, and therefore of the aggregate economy, depends on the rate of savings (s) and the number of companies (N). Thus, the differences in growth rate between States can be interpreted in different saving behaviour and economies of scale. These results illustrate the key role that can be played by the State through government investment, private investment boosting (increasing the number of companies), and through the achievement of fiscal and monetary stability to provide an appropriate banking environment that fosters saving ratio by improving confidence in the performance of financial markets and laying the independence of the Central Bank to ensure relative stability of the value of money.

V. Privatization in Saudi Arabia: a coherent deep process

One of the planned objectives of Vision 2030 is to increase the efficiency of government spending and attain financial balance through instruments to support industries and private sector enterprises and to promote and strengthen the partnership between the public and private sectors. According to the strategic objectives set, the private sector is expected to contribute ominously to supporting and financing the initiatives of the economic transformation program in Saudi Arabia . Astructural change gives the private sector more opportunity and eases the weight on the state budget by seeking substitute sources of government expenditure. In this context and in relation to the privatization program, the government has recognized a number of strategic objectives, including:

- Improvement of non-oil revenues
- Reinforcing fiscal governance
- Reach sustainability in public debt
- Privatizing some government services and assets
- Raising the efficiency of government services
- Diversify innovative funding sources and improve the financial efficiency of the education sector
- Increasing the participation of the private sector in education…

The strategic objectives are embodied with a coherent process of institutional development adopted by the Saudi government to develop the general environment of investment. Accordingly, a privatisation program in the Vision Realisation Program (VRP)[5] has been instituted to support the role of the private sector. This program supports direct and indirect objectives to grow the capital market, draw foreign direct investment, raise SME contribution to the economy, diversify government incomes, and scheme a proficient government structure. Furthermore, privatizing a number of government services will recover the quality of services and decrease government's spending; it will also relieve the government of relocating its efforts

[5]The point over the variable means variation over time. As an example: $\dot{K} = \left(\frac{dK}{dt}\right)$

[6]https://vision2030.gov.sa/sites/default/files/attachments/ncp-delivery-plan-english.pdf

on its legislative and organizational roles. Moreover, the program is projected to draw foreign direct investments and improve the balance of payments.

To achieve these objectives and ensure that the program strategy of privatisation in Saudi Arabia is effective and appropriate and will achieve the desired goals, the current situation has been studied around the major current challenges and current transformative appropriate efforts[6]. Hence, necessary know-how, awareness and skills related to the privatization of state-owned assets are required .The execution of the privatization program in Saudi Arabia may be hard due to several risks which should be allayed.

Incoherence with the new economic growth theory, which adopts investment as a source of knowledge accumulation, these strategic goals are expected to increase the saving rate, improve the efficiency of investment and advance the technical diffusion through the development of the local and foreign private investment.

A. Evolution of the private sector contribution to GDP

The evident effort of Saudi Arabia to fortify the role of the private sector has been successful. Therefore, the contribution of the private sector to non-oil GDP has been growing for more than three decades (see figure 1).

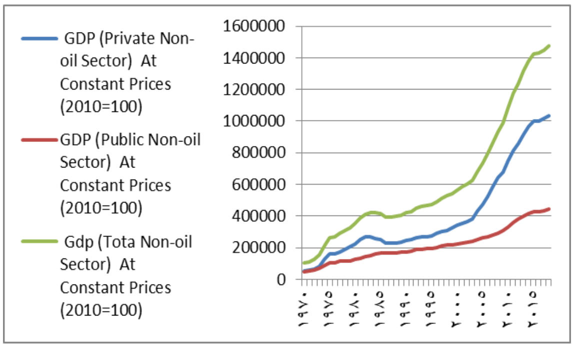

Fig. 1 Evolution of GDP (Million Rials)
Source: Prepared by the author from the General Agency Of Statistics annual report (Saudi Arabia 2019)

Despite this apparent development of the contribution of the non-oil private sector to the GDP in Saudi Arabia, the government sector remains huge, which has led (especially when oil prices fall) to a recurrent deficit in the state budget (figure 2). In light of these conditions, the trend towards further privatization remains a tool to alleviate the state budget deficit.

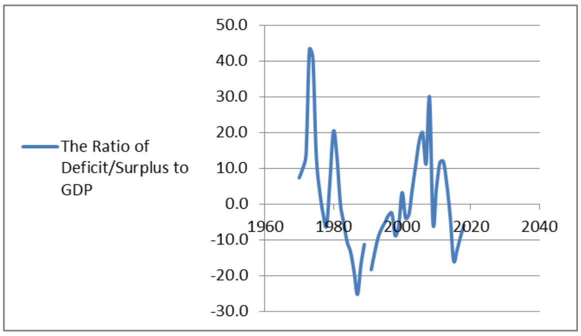

Fig. 2 The ratio of deficit/ surplus to GDP
Source: Prepared by the author from the General Agency Of Statistics annual report (Saudi Arabia 2019)

This structural situation has led to the worsening of the public debt since 2014(figure 3). This situation, reflected in the statistical data related to public finance, is keen to support the role of the private sector in the framework of Vision 2030 to reduce the burden on the government sector, which in turn remains a locomotive driving economic growth in complementarity with the private sector.

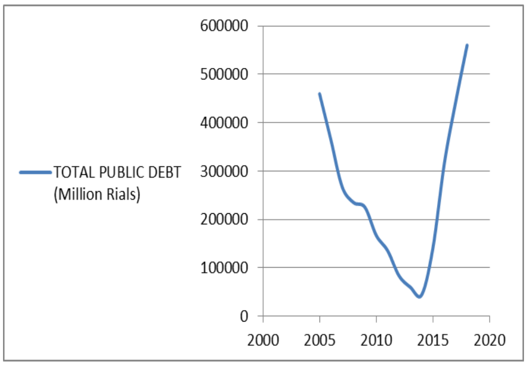

Fig. 3 public debt in Saudi Arabia
Source: Prepared by the author from the General Agency Of Statistics annual report (Saudi Arabia 2019)

VI. CONCLUSION

Given the current situation about the weight of the government sector, the budget deficit and the level of public debt, the private sector should have a crucial role in the Saudi economy. Inconsistency with the institutional theory and new economic growth theory, the constraint of the privatization program as a part of the Saudi Vision 2030 Realization Program (VRP) includes mainly the following two pillars:

-The establishment of a legal and regulatory basis, including the development of a General Legislative Frameworks for Privatization: This requires the establishment of regulatory rules and procedures and addressing the obstacles and legislative gaps that exist in the regulatory environment in general. In addition, this framework is intended to increase regulatory fairness, transparency, and integrity in privatization transactions as well as to enhance the benefits (whether economic or social) of privatization.

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[7]See the Vision Realisation Program (VRP). Privatization program;(Risk Mitigation and Required Actions).

- The establishment institutional basis that contributes to the existence of capable entities to implement privatization in the manner and mechanism that preserves the interests of the government and guarantees the fairness of the process for participants from the private sector, including the development of a structural mechanism of the "Opportunity Explorer": A regulatory approach will be developed to explore potential projects for the public-private partnership and asset-sale. Steer privatization programs initiatives to Review sector-specific strategies.

In privatizing, policy-making and strategic objectives in vital sectors such as education, health, electricity, water and other natural resources remain the responsibility of the state as it is responsible for preserving the values and privacy of society, ensuring the quality of life and preserving national wealth without neglecting the interests of future generations. Specific privatization programs should be adopted on a clear and strategic basis that takes into account the economic, cultural, social and environmental aspects in the short and long term.

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