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The Saudi monarchy and economic familism in an era of business environment reforms

Abstract: In recent years, Saudi Arabia has strengthened its regulatory and financial institutions and adopted many reforms concerning its business environment. Yet, Saudi Arabia seems an unlikely country to succeed at implementing business environment reforms given the presence of an authoritarian state and rent-seeking behavior from elites that is the outcome of oil wealth. What explains the ability of Saudi Arabia to initiate reforms that many states have struggled to implement or uniformly reject? This paper argues that the country's monarchical system helps the government solve the credible commitment problem with private sector elites, thereby facilitating business environment reforms. The monarchical system does this by legitimizing and reinforcing the institution of economic familism. The salience of this institution provides a reliable guarantee to private sector elites that their rents and business interests will be protected during the reform process. The case of Saudi Arabia stands as an important example of how absolute monarchies can pursue certain economic reforms, and also how an informal institution can solve the credible commitment problem in an authoritarian context where formal institutions are either absent or weak.

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1 Introduction

Over the last 15 years, Saudi Arabia has strengthened its regulatory and financial institutions and adopted more reforms concerning the business environment than most of its regional neighbors. In 2013, the World Bank declared Saudi Arabia the region's highest-ranking economy on the "overall ease of doing business," placing it globally at the 22nd spot among 185 countries.[1] Although these rankings are sometimes criticized and many argue that Saudi Arabia's record of reform is less remarkable, there is much evidence from country and regional experts,

1 The World Bank's *Doing Business* reports and rankings are available online at: http://doingbusiness.org.

journalists, and non-governmental think tanks that Saudi Arabia has made progress towards improving the business environment for entrepreneurs and investors.

What explains Saudi Arabia's ability to initiate business environment reforms that many states – authoritarian ones, in particular – struggle to adopt or uniformly reject? This paper argues that a monarchical system[2] helps Saudi Arabia in sustaining a program of business environment reform. This is because monarchies are better able to solve the credible commitment problem between the government and existing private sector elites than non-monarchical, authoritarian states. As many argue, the inability to solve the credible commitment problem often impedes reform in the authoritarian context. The presence of substantial oil wealth can make reform even less likely, given that private sector elites engage in "rent-seeking behavior" and should be concerned that liberalizing reforms could threaten their access to rents from the state. In many ways, Saudi Arabia seems an unlikely country to succeed at a program of liberalizing business environment reforms.

How does Saudi Arabia's monarchical system help solve the credible commitment problem? As the paper illustrates, the monarchical system legitimizes and reinforces the familial ties that exist between leaders and the private sector as well as within the private sector itself. The Saudi monarchy's reinforcement of an informal institution of economic familism provides a guarantee to private sector elites that their rents and business interests will continue to be protected over the long run. Consequently, business environment reforms will not threaten elites' interests, but may in fact bring them greater economic gain.

The paper begins by outlining a theory of how the enduring presence of a dynastic monarchy can help facilitate the adoption of economic reforms, in particular those that address the nation's business environment. Next, I rely on data from scholarly studies, media reports, government publications, select elite interviews, and cross-national quantitative datasets to document and interpret the emergence of these reforms in Saudi Arabia. The specific ways in which the Saudi monarchy legitimizes and reinforces the institution of economic familism is then examined in detail. One main contribution of this paper is that it provides a salient example of how an informal, culturally-defined institution can create the space for economic reform in a context where an authoritarian state is present, rent-seeking behavior is entrenched, and formal institutions are either absent or weakly protect the private sector.

2 Throughout the paper, the term "monarchy" is used to refer to dynastic monarchies that exercise absolute rule. For a discussion about the categorization of monarchies see Lucas (2004).

2 Monarchy, economic familism, and the logic of reform

Scholars often approach the question of how to get key economic actors on board with reforms by discussing the need for a "credible commitment." Specifically, the government needs to ensure key economic actors that it is committed to protecting their interests throughout the reform process, at the minimum by respecting the terms of existing contracts and the rights of private property holders. This commitment is perceived as more credible if there is an institution or mechanism that can "tie the King's hands," and thereby force the government to honor actors' interests into the future. The challenge in the authoritarian context is that, even if there are formal institutions that supposedly protect the interests of private sector actors, the government can ignore or overrule them whenever it wants. Thus, private sector actors have little reason to trust the government and are more likely to try and block reforms in order to preserve the status quo.

Finding a solution to the credible commitment problem in this context can be difficult. Mancur Olson suggests that successful autocrats establish credibility by playing the role of the "stationary bandit," in which they rationally provide public goods while not over-extracting from the population.[3] Yet, Stephen Haber, Armando Razo and Noel Maurer argue that the stationary bandit solution suffers from both practical and theoretical failings: "The practical problem is that no one lives forever. The time horizons of despots are not infinite.... The theoretical problem is that the despot's commitment ... is purely volitional."[4] Other potential solutions to the credible commitment problem include constitutionally limiting the government's power[5] or creating an independent body, such as a guardian judiciary, that prevents the government from violating the rights of investors and asset holders.[6] Reputational norms, a hostage mechanism,[7] or third party enforcement from the international arena or a non-governmental organization could also enforce contracts and guarantee the rights of private sector actors.[8]

A few scholarly studies allude to the idea that a monarchical system – such as the one present in Saudi Arabia for over 80 years – is capable of solving certain

3 Olson (1993).
4 Haber, Razo, and Maurer (2003: p. 4).
5 North and Weingast (1989).
6 Landes and Posner (1975).
7 Williamson (1983).
8 Haber, Razo, and Maurer (2003).

kinds of credible commitment problems. For instance, Gordon Tullock argues that a system of hereditary succession benefits the broader swath of regime-tied elites because it maintains their relative power in the country.[9] Michael Herb holds that Middle Eastern monarchies persist through "consensus" among both the royal family and a broader group of elites unrelated to the family but bound to the regime by the patronage they receive.[10] Recent work by Victor Menaldo posits that monarchies experience greater political stability than non-monarchies because they continually foster a political culture that "[renders] monarchs' promises credible" and "[secures] political elites' trust and loyalty."[11] Moreover, survey research finds that citizens living in monarchies report trusting the government more than citizens in non-monarchies.[12]

The role of "regime-tied elites" may be crucial to understanding the flexibility that monarchies have in policymaking and thus their ability to adopt certain kinds of economic reforms. Lisa Anderson argues that in monarchies "the availability of support from the old elite may allow substantially greater levels of *voluntary compliance* with the state's new extractive ambitions than would rule by 'the people' or 'the proletariat' that alienates the old elite before a new one is available to take its place."[13] In Jason Brownlee's work, hereditary succession is seen as providing a "focal point for reducing uncertainty, achieving consensus, and forestalling a power vacuum."[14] The fact that a study of 27 OECD countries found that over the course of the 19th and 20th centuries monarchies were more likely than republics to implement sweeping, rather than incremental, institutional reforms may be explained by the greater policymaking flexibility inherent in monarchies.[15]

Is there any empirical evidence that confirms these intuitions with regard to business environment reforms? Table 1 displays data on Middle East/North

9 Tullock (1987).

10 Herb (1999).

11 Menaldo (2011: p. 3). Related to these works is a study that shows how an "institutionalized ruling party," the Chinese Communist Party, is able to make a credible commitment to private investors. See Gelbach and Keefer (2011).

12 Bjørnskov (2007).

13 Anderson (1991: p. 4) (italics added). Anderson argues that there is "an affinity between monarchy as a regime type and the projects of nation building and state formation" (1991: p. 3). This logic might be extended to contemporary areas of economic development, such as business environment reforms.

14 Brownlee (2007: p. 597).

15 Bjørnskov and Kurrild-Klitgaard (2008).

Table 1 Business environment, political regime, and oil income in Middle East and North African Countries.

Country	2012 "Ease of doing business" ranking (out of 185 countries)	Regime type in 2010	Polity IV regime type measure in 2010	Oil/gas value per capita in 2010 (in 2009 USD)
Saudi Arabia	23	Monarchy	−10	9814
United Arab Emirates	29	Monarchy	−8	10,850
Israel	36	Democracy	10	67
Bahrain	39	Monarchy	−8	2739
Qatar	40	Monarchy	−10	28,154
Tunisia	45	Party-based	−4	263
Oman	47	Monarchy	−8	10,755
Turkey	68	Democracy	7	20
Kuwait	77	Monarchy	−7	24,686
Morocco	93	Monarchy	−6	1
Yemen	101	Personalist	−2	519
Jordan	105	Monarchy	−3	6
Egypt	110	Party-Military-Personalist	−3	333
Lebanon	112	Democracy	7	0
Syrian Arab Republic	137	Party-Military-Personalist	−7	590
Iran	144	Party-based	−7	2043
Algeria	150	Military	2	2093
Iraq	163	Foreign-occupied	3	2222
Djibouti	171	Personalist	2	0

African (MENA) countries in terms of the "ease of doing business," political regime, and level of oil and gas income.[16] The general pattern suggests that monarchies in the MENA region are more likely than non-monarchies to provide a liberalized business environment. While seven of the ten highest-ranking business environments are monarchies and no monarchy has a ranking below 105th

16 The World Bank's *Doing Business* data and rankings are available online at: http://doingbusiness.org. Political regime data are available from Geddes, Wright, and Frantz (2013) and online at: http://dictators.la.psu.edu/. Note that Djibouti was coded by the author. Political regime type measures are available from the *Polity IV Project* and online at: http://www.systemicpeace.org/polity/polity4.htm. See Marshall and Jaggers (2012). Oil and gas data are available from Ross (2013) and online at: http://www.sscnet.ucla.edu/polisci/faculty/ross/.

(Jordan), the bottom half of the list contains various types of authoritarian regimes, such as military or personalist dictatorships.[17]

However, a country's political regime measure (coded on a scale of –10 to 10 where higher values indicate more democratic regimes) appears to be unrelated to its ease of doing business ranking. Existing research leads us to expect democracies to have more liberalized business environments,[18] but even weakly democratic or "mixed regimes" such as Algeria, Iraq, and Djibouti rank very low. Furthermore, there is no clear pattern with regard to the role of oil and gas income. Four oil-rich countries (Algeria, Iran, Iraq, and Libya[19]) are ranked low while three relatively oil-poor countries (Israel, Turkey, and Tunisia) are ranked high. Indeed, the one consistent pattern in Table 1 is that most monarchies in the MENA region are clustered above or near the global median in the ease of doing business ranking.

What is it about a monarchy that may give it an advantage in pursuing business environment reforms? What is the basis for what scholars describe as "voluntary compliance" or "consensus" between a monarchy and the country's elites? If formal institutions are weakly enforced and the monarchy exercises absolute rule, why would elites trust that the monarchy will continue to protect their interests during a program of business environment reforms?

A monarchy uses the institution of economic familism to solve the credible commitment problem between the government and private sector elites in order to facilitate business environment reforms. In the presence of absolute rule, entrenched rent-seeking behavior, and weakly enforced or entirely absent formal institutions, economic familism can serve as an institution that helps protect the interests of private sector elites over the long run. Economic familism is a system whereby familial ties underpin economic activities and directly shape the norms of interaction between economic actors. The importance of familism in economic interactions and institutions can be observed in places around the world, from China to the Appalachian US, though the form that economic familism takes in each place will vary according to historical experience and cultural interpretations of the concept of family.[20]

17 Libya is missing from the *Doing Business* dataset but appears to follow the same pattern. The World Economic Forum's *Global Competitiveness Index* ranked Libya at the 113th spot out of 144 countries in 2012–2013. Libya was coded a "personalist" authoritarian regime in 2010 (Geddes, Wright, and Frantz 2013). The per capita value of Libya's oil/gas production in 2010 was 8162.10 USD (Ross 2013). While the role of international forces as a cause of business environment reforms should not be ruled out (and is an important topic for future research), the regional data and patterns observed help us to confirm that Saudi Arabia's reforms are not solely the result of pressure from the US.

18 See Djankov et al. (2002).

19 See footnote 17 on Libya.

20 Benedict (1968); Wong (1993); Salstrom (1994).

Common attributes of economic familism include the following: kinship relations are the primary way of financing and facilitating business transactions; family-owned businesses are given preference over non-family-owned businesses; nepotism is a preferred practice in hiring, promoting, and transferring assets; intermarriages commonly occur between established business families; and preferences about financial partnerships are determined by kinship relations. Where a system of economic familism dominates, familial ties guide entrepreneurs in everything from how to raise capital to how to maintain clients. In some contexts, familial ties pre-determine a firm's fate in the economy.

The concept of economic familism should be understood as distinct from what many refer to as "crony capitalism." Crony capitalism concerns "insider" relations between individuals and the government (which may or may not involve familial ties or nepotism), and is interpreted in a negative light as one specific form of corruption. Whereas a system of economic familism can certainly foster crony capitalism as one outcome, in a fundamental sense economic familism is a culturally-defined institution with ambiguous outcomes that involve a far broader array of interactions beyond the relationship between "insiders" and the government. Economic familism can shape virtually all economic transactions by highlighting biological foundations, which has one common manifestation in the prevalence of family-owned firms. Additionally, there is an empirical difference between the presence of economic familism and crony capitalism in countries. The economies of Germany and Sweden, for instance, are highly dominated by family firms but they also score low on corruption indices. These economies are fundamentally different from the classic examples of crony capitalism highlighted by researchers during the East Asian Crisis, such as Indonesia and Malaysia.[21]

Avner Greif's theory about the ability of collective cultural beliefs to induce cooperation among individuals supports the idea that an informal institution of economic familism can substitute for government credibility in authoritarian regimes lacking formal institutions.[22] In Saudi Arabia, the monarchy reinforces the belief that familial bonds in the economy – whether directly to the royal family or through family-owned businesses – provide a guarantee that business interests are protected over the long run. The persistence of economic familism in Saudi Arabia also echoes research by Mark Granovetter about the ways in which interpersonal relationships shape the construction of economic institutions.[23] Finally, the notion that a system of economic familism can subsist during

21 James (2008).
22 Greif (1994).
23 Granovetter (1992).

a process of economic reform is not paradoxical. As Francis Fukuyama points out, "Those who, like Max Weber, argued that Chinese familism would impede economic modernization were simply wrong."[24]

Next, the paper examines the evidence and impact of business environment reforms in Saudi Arabia from the 1990s to the present. It then discusses how the Saudi monarchy solves the credible commitment problem with private sector elites via the institution of economic familism.

3 Saudi Arabia's recent experiences with business environment reforms

Evidence of business environment reforms are found in Saudi Arabia's development plans after 1985, when the government first started to pursue a "more holistic approach to the economy" and embraced a "new vision" for development.[25] Motivated in part by a desire to join the World Trade Organization,[26] the government established new institutional bodies that provided the foundations for an increasingly liberalized business environment to emerge over time. The summation of the government's activities led some researchers to later make the assessment that the "shape taken by Saudi Arabia's political economy since 2000 is similar in some respects to that of the developmental states of East and South-East Asia."[27] Others observe a "new business climate" emerging in Saudi Arabia.[28]

New institutional bodies, particularly the Supreme Economic Council (SEC) and the Saudi Arabian General Investment Authority (SAGIA), were created in the months between August 1999 and April 2000. Whereas the SEC would evaluate the effectiveness of economic, industrial, agricultural, and labor policies, SAGIA was tasked with "promoting foreign investment and serving the interests of the business community" and "playing a mediating role between investors and the government."[29] Just prior to the creation of these bodies, surveys conducted by Malik revealed that business owners viewed the procedural requirements to

24 Fukuyama (1995: p. 95). Researchers continue to investigate whether economic familism produces positive or negative economic outcomes. Most research centers on the role of family ownership in the private sector. See the review and analysis in Bertrand and Schoar (2006).
25 Niblock and Malik (2007: pp. 30 and 106).
26 Saudi Arabia became a full member of the World Trade Organization in 2005.
27 Niblock and Malik (2007: p. 173). See also Looney (2004; Askari 2009: p. 412).
28 Luciani (2005: p. 172).
29 Niblock and Malik (2007: p. 187).

obtain a business license as "tedious," taking up to 6 months with no guarantee that a license will be awarded.[30] Furthermore, applying for credit was understood as a time-intensive and challenging process, as well as one that varied between banks and government sources. After the birth of SAGIA (an intended "one-stop-shop" for the business community), the regulatory barriers to establishing a business and obtaining licenses were reduced. Although this now made it easy to acquire a business license (at least initially), the start-up process remained far from streamlined as other regulatory requirements – for instance, obtaining commercial registration – continued to impose barriers.[31]

Despite the fact that a number of challenges to entrepreneurial activities still exist in Saudi Arabia (discussed more below), there is much evidence that the government has adopted a range of business environment reforms since the 1990s. According to the World Bank's *Doing Business* reports, by 2011 the country had reduced the regulatory procedures required to obtain construction permits, the regulatory procedures and cost of registering property, and the regulatory procedures, bureaucratic delay, and official fees required to open a business.[32] Five years before, Saudi Arabia ranked near the bottom of all nations in regulatory and financial barriers to opening a business, and far below the global median with respect to protections for investors.[33] The *Doing Business* reports are not the only quantitative evidence of Saudi Arabia's improving business environment. The World Economic Forum primarily uses surveys of business executives to generate a "global competitiveness index" that ranks Saudi Arabia 18th out of 144 countries in 2013.[34]

Some experts criticize the *Doing Business* reports as exaggerating the degree of reform that has taken place in Saudi Arabia. It is worth noting that the World Bank's *Worldwide Governance Indicators* indicate a more modest degree of reform in "regulatory quality" between 1996 and 2011. Measured on a scale of –2.5 to 2.5, Saudi Arabia improved its regulatory quality score from –0.15 to 0.005 over this time period, moving the country from the 47th to the 53rd percentile in the world.[35] Indeed, the truth about Saudi Arabia's degree of reform lies somewhere in the middle. While there is considerable evidence that business environment reforms and institution-building efforts have taken place since the 1990s, the fact that entrepreneurs and investors still face a number of government-imposed

30 Malik (2004: p. 136).
31 Hertog (2011: pp. 163–164).
32 World Bank (2011).
33 World Bank (2006).
34 World Economic Forum (2013).
35 World Bank (2013).

challenges to their activities should caution us against embracing some of the more hyperbolic assessments.

Over the last 15 years, Saudi Arabia's government has made efforts at boosting domestic entrepreneurship in the country. For instance, a member of the Riyadh Chamber of Commerce and Industry observed that there are a number of signs that the government is trying to increase training opportunities for local entrepreneurs and encourage more research on entrepreneurship.[36] King Saud University's "Riyadh Techno Valley" is training students in innovation and business planning while offering financial support to the top students to implement their business ideas.[37] The government also continues to provide incentives to private start-ups, such as interest-free, medium- and long-term loans, subsidized leasing at industrial sites, preferential treatment for locally manufactured goods in procurement contracts, and a number of other benefits.[38]

The international media frequently reports on Saudi Arabia's reforms. In 2007, *The Banker* highlighted the creation of a commercial credit bureau that catalogues the credit exposure of Saudi firms. This bureau "will help banks to have a much better picture of local corporate credit and debt."[39] In April 2008, *Asiamoney* reported that a "financial revolution is underway in Saudi Arabia" which has its roots in the June 2003 creation of the regulatory agency the Capital Market Authority (CMA).[40] After initiating its work in 2004, Steffen Hertog notes that the CMA "then got off to a quick start" and "bankers generally recognize it as a more qualified and committed regulator than most other Middle East stock market authorities."[41]

The privatization of state assets, a contentious topic in Saudi Arabia as it is in many oil-rich countries with a nationalized oil sector, has proceeded slowly but steadily since the 1990s. In areas where it has taken place, it has generally been successful. The areas in which the private sector is now most involved include the postal services, ports, telecommunications, insurance, aviation, banking, health, education, water and wastewater management, and mining.[42] Moreover, surveys show high levels of support for privatization from the general public, the business sector, and some members of the royal family and senior bureaucrats.[43]

36 Author's interview with a member of the Riyadh business community, Dubai, June 2009.
37 Clary and Karlin (2011: p. 18).
38 Al-Nefaee (2005: pp. 79–80).
39 *The Banker* (2007). "Economic Cities Point to a Sea Change in Thinking." November 1.
40 *Asiamoney* (2008). "Saudi Unfastens Financial Sector." April.
41 Hertog (2011: p. 255).
42 Akoum (2009); Rivlin (2009: pp. 235–236); Hertog (2011: p. 254).
43 Al-Salloum (1999); Alsaleh (2006).

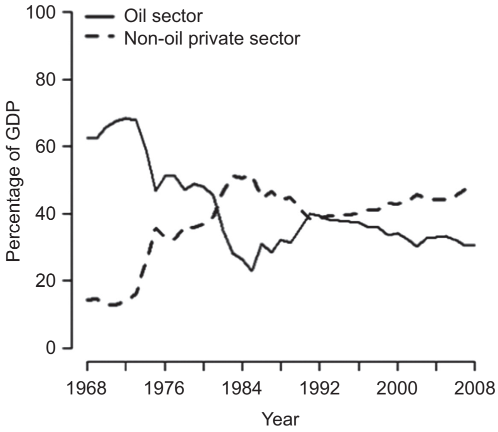

Figure 1 Saudi Arabia's GDP by sectoral percentage.
Source: Saudi Arabian Monetary Agency Annual Report, 2010.

The assorted business environment reforms and government support for private sector activities has resulted in the country's non-oil private sector playing an increasingly important role in the economy. As Figure 1 shows, the non-oil private sector's percentage of GDP has increased since 1968 while the oil sector's percentage of GDP has declined overall.[44] The steadily increasing role of the non-oil private sector from 2001 to 2008 is a particularly strong indicator of the country's commitment to boosting the private sector, given that oil revenues rapidly grew over these years.

There is also evidence that more new, small firms have entered Saudi Arabia's economy since the start of business environment reforms. Although annual data on the number of new small- and medium-sized enterprises (SMEs) is not available, looking at how the average firm size and assets have changed over time can provide insights into the growth of SMEs in Saudi Arabia.[45] Figure 2 plots the change in the average number of workers and total assets of firms in the country's non-oil industrial sectors since 1990.[46]

Whereas the average firm in the non-oil sector employed about 125 workers in 1990, this number steadily declined afterwards. This change can be contrasted with the 1970 to 1990 timespan, during which the average number of workers employed

44 Data to produce Figure 1 are from Kingdom of Saudi Arabia (2010).
45 SAGIA defines small-sized enterprises as those with fewer than 60 employees and medium-sized enterprises as those with fewer than 100 employees.
46 Author's calculation using data from Kingdom of Saudi Arabia (2010).

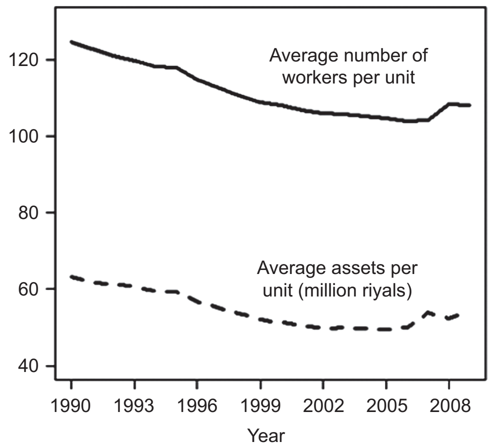

Figure 2 Average number of workers, total assets for non-oil industrial units in Saudi Arabia. Source: SAMA Annual Report (2010) (author's calculations).

per factory grew rapidly.[47] Given that the total number of non-oil industrial units increased from 2065 to 4433 between 1990 and 2009,[48] it is unlikely that enhanced productivity caused this downward trend in average firm size. Instead, it stands to reason that a large proportion of new, relatively smaller firms entered Saudi Arabia's non-oil sector beginning around 1990. The dotted line in Figure 2 helps to corroborate this conclusion. The average assets of firms in the non-oil sector decreased, suggesting that new, smaller firms with relatively less capital entered the market.[49] Evidence of this development is further indicated by a 21% increase in the number of municipal business licenses issued and a 24% increase in the number of municipal construction permits awarded between 2005 and 2007.[50]

Despite the government's efforts in the way of business environment reforms, country experts stress the notion that considerable work still remains to be done. For one, the government makes it easier for foreign- or joint-owned firms to succeed in the market than domestic-owned firms,[51] and yet it still places regulatory barriers on the activities of the former.[52] Also, large firms are routinely

47 Author's calculation using data from Al-Harthi (2000: p. 124).
48 Kingdom of Saudi Arabia (2010).
49 There is variation over time among non-oil sectors. Whereas more small firms have been entering the textile sector and, to a lesser extent, the wood products sector, this is not the case in the paper and leather products sectors (figures available from the author).
50 Almarshad (2011: pp. 331–332).
51 Almutery (2009: pp. 17–41).
52 Hertog (2011: chapter 5).

favored over SMEs,[53] as evidenced by a 1999 report which found that 75% of all bank loans are given to large firms.[54] While the Saudi government makes occasional efforts to increase financial support for SMEs,[55] it is considered below what is appropriate given the importance of SMEs in the domestic economy.[56] For example, the value of guarantees that the Saudi Industrial Development Fund provided to SMEs between 2006 and 2009 was a small fraction of what it provided in actual loans to larger industrial units.[57] Abeer Allam explains why this is the case: "Traditionally, banks felt more comfortable lending to big business families whose senior members usually sit on their boards, while small and medium-sized business owners struggled to get finance."[58]

This being said, there is optimism about what the future holds for SMEs in Saudi Arabia. In 2013, the *Financial Times* quoted economist John Sfakianakis as saying: "More credit will be available for SMEs. It has already changed and it will change [further]."[59] In addition, the 2010 HSBC *Small Business Confidence Monitor* reported that Saudi SMEs have the highest level of business confidence in the Middle East and second highest in the world.[60]

4 Explaining Saudi Arabia's reforms: the role of economic familism

How can we explain Saudi Arabia's ability to initiate reforms that have gradually improved the country's business environment? Given that an authoritarian regime is present, we would presume that the government would struggle with providing a credible commitment to convince existing private sector elites to support reforms that would liberalize the business environment. Furthermore, given that Saudi Arabia is an oil-rich, rentier state with private sector elites who

53 Al-Nefaee (2005: p. 84).
54 Niblock and Malik (2007: pp. 168–169).
55 Saudi Economic Survey (2011a).
56 Ramady (2005: pp. 196–197); Saudi Economic Survey (2011b). In 2008, SMEs comprised 94.2% of all private sector enterprises in the country and provided 62.5% of all job opportunities [Saudi Economic Survey (2011c)].
57 Author's calculation using data from Kingdom of Saudi Arabia (2007).
58 Allam, Abeer (2013). "Arab Finance and Banking: Saudi Small Business Remains Reliant on Friends and Family for Funds." *Financial Times* May 28.
59 Allam, Abeer (2013). "Arab Finance and Banking: Saudi Small Business Remains Reliant on Friends and Family for Funds." *Financial Times* May 28.
60 AME Info (2010). "Middle East SMEs Report High Levels of Business Confidence." July 21.

are highly dependent on the rents they receive from the government, we would expect elites to staunchly oppose reforms that might threaten their preferential treatment and status in the economy. In this section, the paper demonstrates how a monarchical regime uses the institution of economic familism to solve the credible commitment problem between the government and private sector elites. This informal institution makes a program of business environment reforms possible in a context of absolute rule, accelerated and entrenched rent-seeking, and weak formal institutions.

4.1 Oil wealth, rent-seeking, and credible commitments

Reducing uncertainty for private sector elites is essential in order to pursue business environment reforms in oil-rich, rentier states where government-business relations are defined by the dynamics of rent-seeking.[61] In Saudi Arabia, rent-seeking entails gaining access to the royal family, who manages revenues and doles out benefits. As in many rentier states, rents in Saudi Arabia take the form of preferential access to markets, subsidized credit, free inputs, and a range of other benefits. Although rent-seeking may be a highly inefficient activity from the standpoint of societal welfare, it can turn unprofitable businesses into profitable ones, and marginally profitable ones into exceedingly profitable ones. It can reduce or eliminate a firm's competitors and yield an entire range of supplementary benefits, such as the granting of ambassadorships and lucrative jobs for the rent-holder's children. Once rents are acquired by private sector actors, ensuring that they flow both copiously and into the future is the primary goal. If a high level of uncertainty about future access to rents exists, private sector elites have cause for concern and are less likely to support government-sponsored reforms that could alter the economic system or increase competition for rents.

There is evidence that Saudi Arabia has become one of the more advanced examples of a "rent-seeking society" since the nation's discovery of oil. In a place with a high degree of rent-seeking, social and economic interests are "organized in such a manner as to capture a good slice of government rent…. Different layers of beneficiaries of government rent are thus created…. The whole of society is arranged as a hierarchy of layers of rentiers, with the state or government as the top of the pyramid."[62] Although the moniker of rent-seeking society applies well to Saudi Arabia since the discovery of oil, one must be careful not to exaggerate the sense of autonomy that the government has atop the pyramid (as Niblock and

61 See Beblawi and Luciani (1987); Crystal (1995); Bjorvatn and Selvik (2008).
62 Niblock and Malik (2007: p. 16).

Malik point out). Serving as the solitary gatekeeper to rents means that rent-seekers know exactly whom to lobby. Once rent-seekers become increasingly dependent on these rents, as occurred in Saudi Arabia, the state becomes constrained: "Having built a system based on cooptation, the Saudi regime found it hard to retract its commitments."[63]

As time passes, the actors who gain privileged access to rents may be able to play a role in shaping the monarchy's decision-making. During moments of political weakness or economic crisis, the monarchy uses these rents to solidify its relationship with the groups in society that it believes will help bolster its strength. This can "create vested interests that soon establish claims on public resources, are able to limit the future options of state leaders, and become a powerful and systematic clientele of state structures."[64] Through continued rent-seeking over time, these actors begin to play a role in decision-making, especially in regard to economic matters. What transpires, in effect, is that "Rentier states are not necessarily left free to chart whatever economic path they choose."[65]

Evidence of this simultaneous "dependence-influence" relationship between the Saudi monarchy and private sector elites begins to appear by the 1980s. At that point, the private sector elites who were highly connected to the regime began successfully challenging economic policymaking that directly threatened their rents and business interests. This dynamic is a central storyline in Kiren Aziz Chaudhry's study, which analyzes the Saudi monarchy's attempts to reduce the subsidies it was providing to private sector elites after the oil bust in the 1980s.[66] Because private sector elites were highly dependent on these rents, they worked to thwart the government's attempts to reduce their subsidies.[67]

Due to the role of rent-seeking in creating a dependence-influence relationship, in order for the Saudi monarchy to pursue reforms that would open domestic markets and increase competition it needs to provide a guarantee that private sector elites' rents will be protected. In effect, a credible commitment must be made if the monarchy seeks a new, liberalizing economic agenda. This credible

63 Hertog (2011: p. 18).

64 Krimly (1993: p. 11).

65 Niblock and Malik (2007: p. 19).

66 Chaudhry (1997).

67 An alternative implication of Chaudhry's argument is that leaders in oil-rich states should be more likely to agree to limited reforms demanded by the private sector, given that oil wealth provides the state with greater fiscal autonomy and limited reforms are unlikely to carry significant political risk. Although the pattern observed in Table 1 suggests that oil may be less important a factor in the facilitation of reforms than the presence of a monarchy (at least in the MENA region), the role that oil plays in shaping a country's business environment is an important topic for future research.

commitment is made possible through the institution of economic familism. Next, the paper examines family-owned firms and the business activities of royal family members to show how economic familism operates in Saudi Arabia, how the monarchy legitimizes and reinforces this institution, and how it makes business environment reforms possible.

4.2 Rent-seeking and Saudi Arabia's business families

Once Saudi Arabia began exporting large amounts of oil after World War II, many individuals started to engage in rent-seeking behavior and concomitantly carved out important roles for themselves in both economic and political realms. Hertog describes it as the "dizzying years" of the 1950s and 1960s, when "uncontrolled, Byzantine expansion based on patronage" created the opportunity for existing private sector elites to expand their operations and for friends of the monarchy to make forays into the private sector.[68] A number of now powerful business families emerged this way, starting out as exclusive suppliers or serving as former advisers to Ibn Saud. Some of them were "granted exclusive trade agencies by the king, which they still hold today."[69]

The rise of these elites via oil-fueled rent-seeking produced a contingent of powerful family-owned firms in the economy. Today, many of these firms are gigantic conglomerates that dominate the sectors in which they operate and hold a privileged position over firms with less storied histories. A few prominent examples are the Alireza, Khashoggi, Juffali, Jumaih, Pharaon, and Rajhi families.[70] These families conduct activities across a wide range of economic sectors, from banking to construction to defense. The Al Jumaih family, for example, began business activities in the 1930s and is now a multi-billion dollar conglomerate active in automotive services, manufacturing, soft drink bottling, real estate, and more. The Pharaon family made billions in banking, tourism, and petroleum sectors, all the results of the initial activities of Rashad Pharaon, personal physician and adviser to the royal family. By the mid-1980s, Rashad's son Ghaith was reportedly the chairman of the board for 22 corporations.

One of the oldest and most famous family-owned business empires is the Alireza family from the Hijaz region. They began operations in 1845 as an importer of foodstuffs and one branch of the family business became the first company on the peninsula to import and distribute automobiles for commercial purposes.

68 Hertog (2007: pp. 540 and 545).
69 Hertog (2007: p. 547).
70 See Field (1984).

Now a massive conglomerate, the Alireza Company is also active in real estate, shipping, luxury imports, and more. Xenel Industries, a company founded in 1973 by members of the Alireza family, is the firm that was responsible for restoring electricity to Kuwait City after the first Gulf War.

Family-owned businesses play such a substantial role in Saudi Arabia's economy that, in the eyes of many, they define the private sector. Indeed, up to 90% of all companies in the country are wholly family-owned.[71] A 1990 study by John Davis, Elye Pitts, and Keely Cormier estimated that family-owned businesses in Saudi Arabia earned 104 billion USD and contributed 33% of the country's total GDP.[72] A researcher estimated in 2013 that their contribution is 25% of GDP.[73] Family-owned businesses reportedly hold the equivalent of 70 billion USD in investments, and the majority of trade agencies and franchises in the country are owned by roughly 100 family-owned businesses.[74]

Statistics such as these feed a perception that the country's economic landscape is unfairly dominated by a small number of prominent family-owned businesses. Many of Malik's interviewees reported that "it was the old, traditional families and money that owned the majority of company shares listed on the stock market."[75] But while family-owned businesses have dominated Saudi Arabia's private sector since the country's origins, there have also been "very few big newcomers [in Saudi business] since the oil bust in 1986."[76] Most of the big stakes in the economy (as in the bureaucracy) have been "parceled out."[77] Many of these were given by the Saudi monarchy to existing family businesses or individuals who would soon carve out family business empires. Their rents and business interests, in effect, were well-established and supported by the Saudi monarchy long before the onset of business environment reforms.

Another segment of family-owned businesses emerged after the 1950s. Many of these entrepreneurs came directly from the government bureaucracy and opened businesses that became family-owned firms over time and through the government's support.[78] These more recent arrivals to the private sector allied with the older family-owned firms described above, establishing the private

71 Sfakianakis, John. (2009) "Challenges Facing Family Businesses in Saudi Arabia, Gulf." *Arab News* June 18.
72 Davis, Pitts, and Cormier (2000).
73 *Arab News* (2013). "Saudi Women's Role in Family Businesses Still Limited." April 10.
74 Daghsh, Muna (2004). "Family Companies Have SR250 Billion in Investments." *Arab News* April 2; cited in Ramady (2005: p. 200).
75 Malik (2004: p. 134).
76 Hertog (2007: p. 555).
77 Hertog (2007: p. 540).
78 Krimly (1993: pp. 376–381).

sector as the place for bureaucratic elites to turn to for opportunities after leaving the government. In many cases, bureaucratic elites turned to the private sector well before leaving the government.

The alliance between family-owned businesses and bureaucratic elites in Saudi Arabia is solidified through intermarriages and the preferred practice of transferring ownership of assets from father to son.[79] Intermarriage among family-owned businesses reinforces both the familial underpinnings of firms and the salience of kinship ties throughout the private sector as a whole. Studies of Saudi businesses confirm that managers are primarily loyal to their own family and kinship groups, and generally oriented towards supporting the collective over the individual.[80] Stig Stenslie further states that in Saudi Arabia, "The family is the primary basis of identity and status for the individual and the immediate focus of individual loyalty."[81]

Despite the common practice of intermarriage among prominent business families, the results are not always beneficial for both parties. An ongoing financial scandal in Saudi Arabia concerns familial ties between the Al Gosaibi family conglomerate and Maan Al Sanea, owner of the Saad Group and husband of Sana, sister of Saud al Gosaibi. After their marriage, whereby Al Sanea "gained the trust of the al Gosaibi family," he was accused of defrauding the al Gosaibi family conglomerate of $9.2 billion. This example aside, cooperation and coordination among family-owned businesses is facilitated by the practice of intermarriage which can build bonds of trust between previously unconnected family-owned businesses. This has also led family-owned businesses to "have the tradition to do business among themselves,"[82] and further strengthens the salience of familial ties in the private sector.

The Saudi monarchy reinforces the institution of economic familism through its hands-off approach towards regulation of family-owned businesses and preferential treatment in terms of credit. Mohamed Ramady states that the government "has not yet reached the stage of imposing regulations on family-run businesses," but instead encourages "internal reform" of these firms.[83] A number of scholars and journalists highlight the lack of transparency among family-owned businesses, a phenomenon that emerges not just in Saudi Arabia but throughout the Gulf region. Abdul Kadir Hussain explains that family-owned businesses "have

79 Krimly (1993: pp. 357–358).

80 Al-Awaji [(1971); cited in Wilson (2004: p. 13)].

81 Stenslie (2012: p. 79).

82 Parasie, Nicolas and Dinesh Nair (2010). "Gulf Reforms Key to Private Equity Regaining Allure." *Reuters* August 12.

83 Ramady (2005: p. 201).

not to a large extent embraced those kind of things like corporate governance and disclosure and transparency."[84] Ramady similarly describes family-owned businesses as "maintaining a quixotic way of doing business."[85]

With regard to credit, family-owned businesses are routinely given preferential treatment by banks and government sources. For instance, in light of the Al Gosaibi family scandal, it was observed that "marriage played a key factor in who obtained what credit facilities backed by cross-family guarantees."[86] An advertisement in the *Washington Post* on Saudi Arabia's newly liberalized business environment even boasts: "Creditworthiness and stability are two things that the second generation can also count on when taking over the business from their fathers, which come in handy if a company needs to raise money for future expansion or diversification projects."[87]

The monarchy's support for family-owned businesses reinforces the role of economic familism as an important institution in the country. This institution sets norms for what types of firms receive preferential treatment in the economy, which in turn directly shapes the decisions of investors and asset holders. As a result, entrepreneurs who can partner with an established family-owned business are at a major advantage in Saudi Arabia. Ramady further explains, "To an outsider, it would be difficult to discern who is related to whom by marriage or blood affiliation, but for those operating in the Kingdom this is more transparent and it influences how business is carried out."[88] As these informally-defined practices become embedded over time, and as the monarchy credibly commits to supporting the activities of family-owned businesses, the adoption of business environment reforms becomes possible.

4.3 Economic familism and the royal private sector

The institution of economic familism allows for a credible commitment to be made to another important segment of the Saudi private sector: members of the royal family who engage in business activities. Convincing this group of private sector elites that their interests and rents will be protected throughout the reform process is critical, and it should not be assumed that the monarchy will automatically satisfy all of their interests. Despite its longevity, Saudi Arabia has not been

84 *Saudi Gazette* (2012). "Syndicated Bank Lending in KSA Doubles in 2012." November 12.
85 Ramady 2009.
86 Ramady, Mohamed (2009). "Saudi Family Businesses Sink Under Debt." *The National* July 4.
87 *Washington Post*. nd."Saudi Arabia: Climate for Change."
88 Ramady (2005: p. 201).

immune to conflict within the family and in regard to economic matters. Furthermore, "the vast majority of princes are not members of the strategic elite: most royals have little or no influence at all over decision-making processes."[89] Indeed, many of the royal family members who entered business are those who left the political sphere "when they realized they would have no chance of advancing through the system."[90] Consequently, a credible commitment is needed to guarantee that these royals' interests will be protected throughout the reform process.

Examples of royal family members joining the private sector are abundant, because many of them began entering the private sector after the oil boom years of the 1970s. Madawi Al-Rasheed explains, "Saudi Arabia began to produce its own businessmen, some of them direct descendants of Ibn Saud. The lines between state finances and individual wealth became blurred as some princes used political office for personal financial benefit."[91] But whereas the division between the ruling family and royal private sector elites became indistinct into the 1980s and afterward, the division between the royal private sector elites and the rest of the private sector became increasingly stark.[92]

Mishaal bin Abdul Aziz, son of Ibn Saud, is one of the more notable members of the royal family who entered business early on and achieved tremendous success. He founded the Al-Shoula Holding Group in 1970, a multi-billion dollar firm whose main activities are in real estate development, with a recent expansion into petrochemicals services. It was reported that control of Al-Shoula was handed over to Mishaal's son, Prince Abdulaziz bin Mishaal, during the late 1990s. Other sons and grandchildren of Ibn Saud have also attained success in the private sector. Nawwaf bin Abdul Aziz is a major investor in the real estate and energy sectors. Other royal family members who have found success in the private sector include Mohammed bin Fahd, Faisal bin Salman, and Abdul Aziz bin Fahd.

Undoubtedly the most famous Saudi royal family member to make a mark in business is Prince Al-Waleed bin Talal, often called "The Arabian Warren Buffett." He is the richest Saudi Arabian and, as of 2012, the 26th richest person in the world. He has amassed a fortune from real estate and investments in Citicorp and News Corporation, among others. Prince Talal's investments have in turn benefited other members of the royal family, such as his sister Sultana Nurul Al-Waleed, who reportedly owns 16% of the Savoy Hotel in London, which Talal bought in 2005.

89 Stenslie (2012: p. 39).
90 Stenslie (2012: p. 57).
91 Al-Rasheed (2002: p. 220). See also Sharaf (2001).
92 Al-Rasheed (2002: p. 154).

The individuals mentioned above are examples of sons, grandsons, or granddaughters of Ibn Saud who entered the private sector. When we widen the scope of inquiry to include nephews and more distant relatives, we observe a similar pattern. Some of this expansion of the royal family's private sector activities was due to the fact that Faisal, half-brother and successor to Ibn Saud's son Saud, extended benefits to individual members of his own family branch who were technically not related to Ibn Saud. Regarding the rents that Faisal distributed, Hertog holds that although the "clientelist distribution of budgets and deals was relatively well controlled under Faisal, his rule was no exception to the basic pattern."[93]

Additionally, these royals are rarely alone in their economic activities but instead "[surround] themselves with growing numbers of hangers-on, advisers, and business partners."[94] As a result, the influence of royal private sector elites extends beyond the actual royal family itself. This network allows non-royal entrepreneurs to gain a major advantage in the market if they are able to get a royal patron on board with a project. Thus, royal private sector elites are not the only ones who have directly benefited and built up their business activities over time: a layer of non-royal entrepreneurs are also capitalizing on this branding of the "royal private sector" through personal, familial, and business relationships. Unsurprisingly, the ability to establish a solid link to the Saudi royal family can make a remarkable difference in terms of an entrepreneur's access to rents.

As Al-Rasheed notes, drawing from within the royal family to create a segment of the private sector blurs the lines between government and private sector, but it also creates a group of principled, family-tied economic elites for whom the credible commitment problem is easily solved – provided that an institution of economic familism is present. Because of their direct familial ties to the monarchy and the salience of economic familism, these elites are more likely to perceive that their rents and interests will not merely continue to be protected during the reform process but that they will logically be the first to benefit from new economic opportunities. Indeed, private sector elites who come from the royal family often block attempts by other groups to dominate sectors of the economy and prevent outsiders from gaining excessive economic influence.[95] There are many reports of royal private sector elites abusing their power and influence to gain advantage over non-royal members of the private sector.[96]

93 Hertog (2007: p. 553).
94 Hertog (2007: p. 545).
95 Rivlin (2009: p. 237).
96 Stenslie (2012: p. 59).

Though the vast majority of royal private sector elites do not hold decision-making authority, some "business-minded princes" have been influential in shaping economic policymaking in recent years.[97] The creation of the SEC in 1999 helped boost the policymaking influence of a select group of royal private sector elites. Prior to the SEC, the country's economic issues were under the jurisdiction of the Ministry of Planning, an organization that had "responsibility without power."[98] Hertog's research on the development of the Saudi bureaucracy further emphasizes the role that familism plays in institutional design in the country: "Saudi bureaucracy building often seems not to be a case of 'form follows function' but of 'form follows family.' ...power politics within the family – whatever its details – consistently loomed larger than other considerations when it came to negotiating institutional change."[99] As select members of the royal private sector continue to shape policy and bureaucracy building, the institution of economic familism endures and becomes strengthened.

Envisioning an institution other than economic familism capable of solving the credible commitment problem between the monarchy and royal private sector elites is difficult. Given that the longevity of the monarchy itself is, in part, determined by its ability to coordinate and satisfy the needs of the royal family members who compose it, providing a credible commitment to these royal private sector elites is synonymous with preserving the monarchy. Implementing business environment reforms that directly threaten the interests of royal private sector elites would only harm the monarchy, providing policymakers with a disincentive to implement reforms that do not benefit them. Implementing reforms that liberalize markets and improve the business environment – while still protecting the interests of royal private sector elites through legitimizing and reinforcing the institution of economic familism – would be possible. Without an institution to solve the credible commitment problem, however, royal family members with substantial investments have reason to fear that liberalizing reforms and increased market competition could threaten their business interests.

5 Conclusion

This paper argued that Saudi Arabia has been able to initiate business environment reforms because the monarchy continually legitimizes and reinforces an

97 Wilson (2008: pp. 134–135).
98 Wilson (2004: pp. 26–27).
99 Hertog (2007: p. 555).

institution of economic familism that solves the credible commitment problem with private sector elites. Without the presence of economic familism as an important institution, private sector elites living in a context of absolute rule, entrenched rent-seeking, and absent or weakly-enforced formal institutions are likely to oppose business environment reforms, fearing that they could threaten their access to rents and increase market competition.

It is important to state that, although Saudi Arabia has made progress towards reforming the business environment, a number of issues remain inadequately addressed. The country has an abysmal record when it comes to supporting women-owned businesses (even compared to its Gulf neighbors), despite some individual exceptions from the royal family or traditional business families.[100] Moreover, most Saudi firms engage in petty corruption and bribery in order to facilitate licenses and smooth their relationships with government officials,[101] though this practice is common in many countries. Furthermore, questions remain about whether reforms of the business environment will lead to a group of entrepreneurs with an organizational identity. Although business in Saudi Arabia, as a class, has become "much more mature" over time and relative to the Saudi bureaucracy, it remains limited in its ability to directly shape policymaking.[102] Finally, there is some skepticism that the country can ever move towards a fully liberalized business environment given the need to continually protect the entrenched interests of existing private sector elites.

As Table 1 indicates, Saudi Arabia is not alone among the region's monarchies in its pursuit of a more liberalized business environment. The ability of other regional monarchies to pursue similar reforms may help explain why these countries (as of writing and with the exception of Bahrain) have experienced less political instability than some of their neighbors during the "Arab Spring" of 2011–2013. By engaging in reforms that directly impact the domestic private sector, the government has opened up more avenues for independent wealth generation,

100 See Stenslie (2012: pp. 59–60). Some government publications try to suggest otherwise (Kingdom of Saudi Arabia 2007). However, this may be slowly changing. An interviewee stated: "Female entrepreneurship in Saudi Arabia is on the rise. Women have been successful in lobbying the government for greater freedoms to conduct business. Many have been successful in encouraging new policies, and providing greater opportunities for females to open businesses. This is a very positive sign" (Author's interview with economist, Dubai, June 2009); See also International Crisis Group (2004: pp. 24–25).

101 Niblock and Malik (2007: p. 206).

102 Hertog (2011: pp. 250–251 and 257–258). An interviewee stated: "The small business sector... does not yet possess a well-organized interest in Saudi Arabia. It is not like the West where you have a culture of organization among small businesses and annual meetings of owners and the publication of journals and all" (Author's interview with economist, Dubai, May 2009).

possibly curtailing one potential source of powerful government opposition. Indeed, there are lessons from other countries in the region about what happens if a monarchy does not support the rise of important segments of the domestic private sector. Iran's revolution against a monarchy in 1979 occurred in large part due to the financial and mobilization efforts of firm owners and entrepreneurs among the country's *bazaar* sectors.[103]

Saudi Arabia's experience with business environment reforms also leads us to question the long-standing argument about a "king's dilemma," whereby monarchies are inherently unable to pursue modernization without risking their own downfall.[104] Although the concept of "modernization" has lost its appeal among scholars in recent years, to the extent that business environment reforms are one facet of "economic modernization," we can conclude that Saudi Arabia is an exception to the king's dilemma in this respect. Though the king's dilemma may still apply to Saudi Arabia in terms of political or social modernization, a sustained program of economic reforms has the capacity to spark reforms that go beyond the market, into society and politics.[105] Entrepreneurs and firm owners may be economic actors on a fundamental level, but they are also social actors and, as the case of Iran illustrates, can be highly effective political actors. Given a commitment to expanding opportunities for the private sector over time, entrepreneurs may shape political and social reforms in Saudi Arabia.

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103 See Parsa (1989).

104 Samuel Huntington coined the phrase "king's dilemma" to describe the fundamental problem that monarchies face when considering modernization. See Huntington (1968: p. 177). See Anderson (1991) on Huntington's argument.

105 For a discussion of Middle Eastern monarchies and the prospects for political liberalization see Lucas (2004: pp. 112–117). See also Luciani (2007).

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