THE RE-EMERGENCE OF THE SAUDI ARABIAN CONSTRUCTION SECTOR[1]

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The Kingdom of Saudi Arabia has more than twenty per cent and ten per cent of the world's oil & gas reserves respectively. It is quite rightly seen as the powerhouse of the Arabian Gulf economy.

The Kingdom has a population of twenty-five million, including six million foreigners. About forty percent of Saudi nationals are under fifteen and because the country has one of the world's highest birth rates, the population is expected to reach nearly forty million by 2025. The Saudi Government therefore has made it a social and political necessity to develop its economy to create employment opportunities for such a growing population. That being said, the path of modernisation and economic development has been pursued for some time now. But poor oil prices, from the mid-1980s through the 1990s, frustrated such development. After all, incredibly, the Saudi Government still relies on petroleum exports for eighty percent of its revenues and oil sales account for half of the country's gross domestic product. Of late of course the Kingdom benefitted from rising oil revenues on the back of the steep hike in oil prices.

However the use of surplus revenues and the rechanneling of oil revenues towards the non-oil sector of the economy is a policy that the government in Riyadh appears to be firmly committed to. Everyone in Government talks of moving from a resource-based economy to a knowledge-based economy just at the time when the financial resources exist to encourage such a move. At the same time Saudi Arabia wants to be an economic hub for the region. To be fair, high expenditure levels, particularly in areas such as infrastructure development, underline a commitment to such economic diversification. Sectors such as finance, construction, transport, communications and petrochemicals have experienced strong recent growth, which will all help to reduce the Kingdom's dependency on its supplies of "black gold."

The Saudi government is certainly giving priority to projects that ensure sustainable and balanced development in addition to employment creation opportunities. Take the petrochemical sector in the Kingdom as an example. The sector affords the country an excellent path toward economic diversification. Petrochemicals provided nine per cent of GDP last year, up from seven per cent a decade ago. Twenty years ago, Saudi Arabia was a net importer of petrochemicals. Today it is one of the worlds leading petrochemicals exporters, supplying over one hundred countries and accounting for around seven per cent of the global supply of basic petrochemical products. Of course the last twelve months have been difficult for the industry. But the Kingdom's oil reserves provide a cost arbitrage over competitors and this enables the Kingdom to expand petrochemical output thereby attacking high cost producers elsewhere who

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are finding it difficult to reduce prices despite there being a global oversupply due to less demand as the recession bites.

But even this focus by the Government on developing its petrochemical industry may not be as great as that afforded to those sectors which will provide the nation with long-term human capital development. The government has prioritised investment in education and healthcare in order to boost the presence of nationals in the economy and to stimulate the development of knowledge-intensive sectors. Indeed, as is the case in other emerging economies such as India, Saudi Arabia's young population is likely to be one of its key advantages going forward. Such key focus will be directed on infrastructure, services and non-oil manufacturing, financial services, tourism and mining.

Even at a time when the international economic downturn is hurting many economies globally, Saudi Arabia remains confident that foreign direct investment (FDI) will flow freely into the economy. If this confidence turns out to be well-placed, the continued inflow of FDI together with state spending will assist the country's record growth levels which others can only dream of in these challenging times. For example as far as those state spending plans are concerned, the government has allocated four hundred billion dollars to just the healthcare and infrastructure sectors alone over the next five years. There are some very attractive fundamentals to the Saudi economy which are tempting international investors to the Kingdom. For example, economic stability, a strong and well-regulated banking system and foreign investment laws and regulations that are pro-investor. Of course many investors have lingering concerns such as getting paid on time, the transparency of the judicial process and a conservative social environment.

The construction industry in Saudi Arabia has shown itself this year to be a lot more resilient to the shocks that have rippled across the Gulf following the onset of the global economic downturn. The Kingdom is set to attract a healthy amount of investment into its real estate sector. The burst of the Dubai real estate bubble has left Saudi Arabia to be the largest construction market in the Gulf with the value of new construction contracts awarded to main contractors in Saudi Arabia expected to reach eighty billion dollars in 2010, a fifteen per cent increase from last year's figures. This is a sector that clearly has a number of positive fundamentals.

For any international or regional construction services provider, the potential rewards in the Kingdom cannot be ignored easily. The investment planned for the rail, power and water sectors eclipses that of other GCC states and the creation of a number of multi-billion dollar integrated new cities affords plenty of opportunities. For example it is well-documented that the Kingdom urgently requires vast numbers of construction professionals given the fact that the schemes and projects underway are of an unprecedented scale. The King Abdullah Economic City for example, 150 km to the north of Jeddah, on the Red Sea, is a new built conurbation integrated with industrial and port super infrastructure and a development cost of twenty-five billion dollars in the first phase alone.

From a corporate establishment point of view, few international construction companies should have major difficulties establishing a presence in the Kingdom provided the investment and classification rules are followed accurately. It is of course sensible to consider joint ventures as a way of avoiding common pitfalls when bidding and executing projects in the Kingdom. A joint venture with a strong local partner means you can have confidence about working conditions in the country and will feel more confident about operating in an unfamiliar legal and cultural environment, where otherwise the business and cultural etiquette may be hugely challenging. Recently, Arabtec Holdings of the UAE, the region's largest listed contractor, announced the formation of a new joint venture in the Kingdom. This new company is 40% owned by Arabtec but will be able to call upon the vast local experience of the Saudi Binladin Group (SBG) since CPC Services, which has a stake in Arabtec Saudi Arabia, is itself part of SBG. Al Rostamani Pegel, another UAE-based construction giant, is also now establishing a presence in the Kingdom.

Saudi Arabia's developing real estate sector continues to grow on the back of core demand and the rapidly growing young population that is looking to become homeowners. Demand currently outstrips supply across all sectors and price levels, especially residential and office space. At present the Kingdom is facing a massive shortage of housing units because of huge demand-supply gap. With inflation generally on an uppish trend and disposable income levels unable to keep pace, the Kingdom is experiencing an acute need for affordable housing. The Government will look to address this need with plans over the next two years to deliver hundreds of thousands of low-cost units whereas the country requires an estimated total of one million housing units within the same period. A Saudi mortgage law, which would establish a housing finance market, has been long-awaited and was finally approved by the Shura Council in July last year. It is the view of most commentators that domestic finance products will only further tap into demand for housing. Sharia-compliant mortgage financing credit is also now being formulated by all the major banks in the Kingdom as they await the law to actually come into force. A number of international housebuilders are now circling around the Kingdom sizing up potential partners for entry into this lucrative market.

Public Private Partnerships (PPPs) have of course become a viable and innovative procurement regime for developing infrastructure assets and services throughout the world in recent years. The Government in Saudi Arabia is on record as saying it is committed to increasing the involvement of the private sector in the development of public infrastructure and services. Given the reduction in Gulf oil revenues, the funding of economic and social infrastructure and the ability to take projects off the Government's balance sheet, using PPP is likely to grow in momentum.

However in Saudi Arabia it is also the sharing and management of risk which will be a key benefit that the Government requires. Saudi Arabia desperately needs to improve the delivery of major capital projects. Quality and efficiency is another benefit which PPP in Saudi Arabia will bring. In a genuinely competitive environment PPPs tend to produce infrastructure of a higher quality than the more traditional method of publicly-financed projects. PPPs encourage operational efficiencies, including a focus on the output or service and the transfer of skills to the public sector. The Kingdom has often lacked such efficiencies and those companies with experience in PPP delivery will want to increase their attention in the Kingdom.