Saudi Arabia has announced a trillion-dollar pipeline of infrastructure projects aimed at diversifying the economy beyond oil and positioning the kingdom as a global hub for investment and logistics. The development agenda has created opportunities in a range of new areas such as smart cities, tourism and clean energy. But while the country is telling the world that it's open for business, the plans are beset by challenges: low levels of foreign direct investment and shaky investor confidence coupled with corporate financing constraints will require new approaches in politics and governance.

NEOM, Red Sea and Qiddya – planned centres for innovation, tech and tourism

Despite potential financing constraints caused by the postponement of Saudi Aramco's $100bn initial public offering to at least 2020, the Saudi government and its Public Investment Fund (PIF) are continuing to push forward projects linked to the implementation of Vision 2030 – the kingdom's long-term blueprint for economic diversification, social development and job creation.

Seen as the country's diversification engine, with approximately $300bn in assets and an additional $100bn expected by next year, PIF is tasked with developing a handful of flagship gigaprojects – large-scale greenfield developments worth billions of dollars – in addition to a raft of other real estate and infrastructure projects. It is also responsible for investing in key domestic equity holdings and strategic international assets as well as new economic sectors.

The largest of the gigaprojects is a $500bn futuristic city called NEOM, which is planned for construction in Tabuk, a disadvantaged region in north-west Saudi Arabia. Ultimately, PIF wants NEOM to become a global centre for knowledge, innovation and technology, which draws on international investment and talent to develop some 16 sectors, including energy, transport, biotechnology and food. It also aims to develop it as a tourism destination.

As the leadership's model for the kingdom's future, NEOM has received more publicity than any other project, but its development remains uncertain. The first phase is expected to be completed in 2025, but until the authorities release a general strategy at the end of this year it will be impossible to determine whether the deadline is realistic.

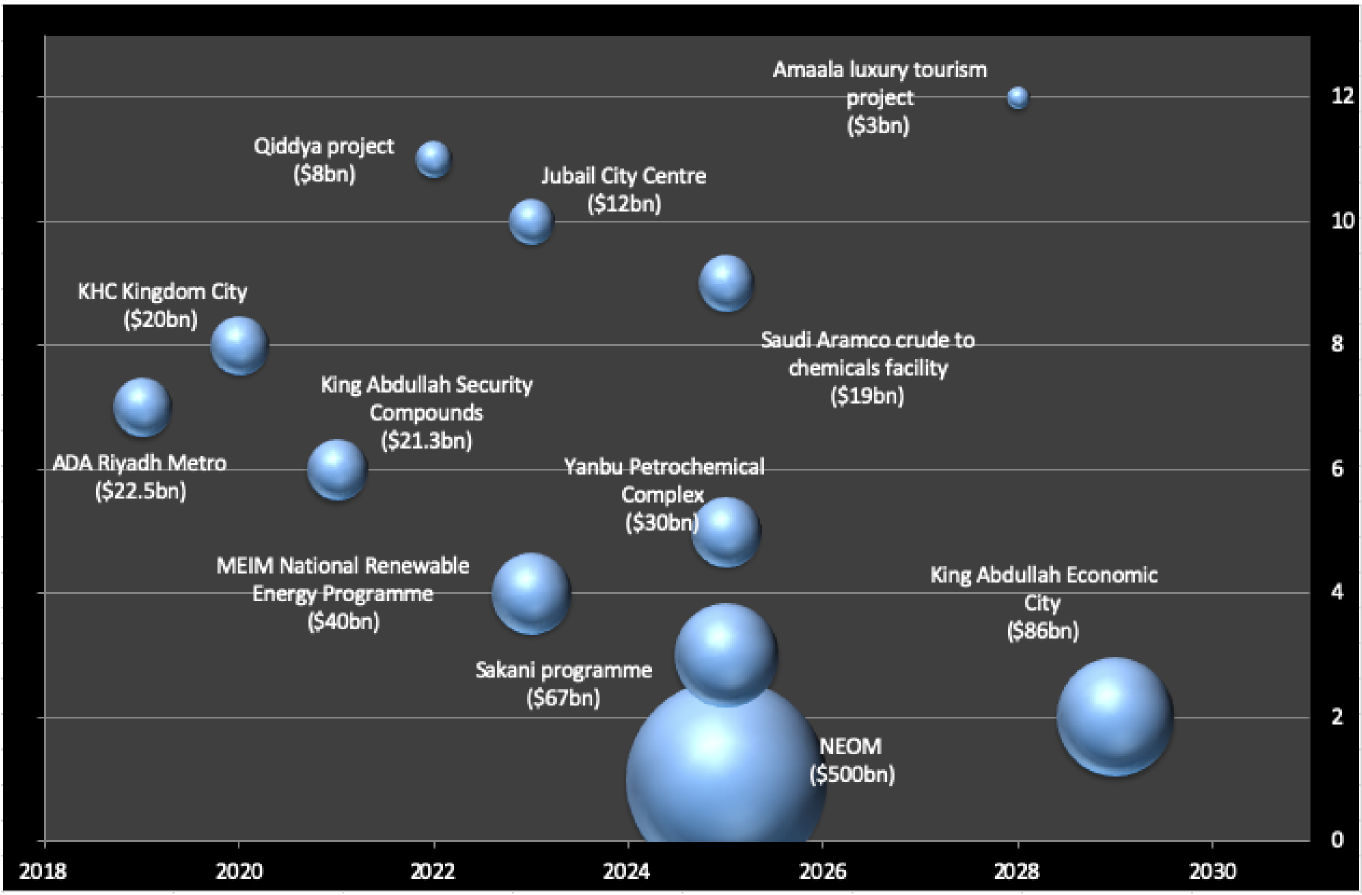
The three other PIF-backed gigaprojects primarily target the tourism and entertainment sectors. The Red Sea Project, whose value is unknown but has an expected annual economic contribution of $5.9bn, should develop its first phase by 2022. The plan includes development of some 14 luxury hotels across five islands, and aims to create 70,000 jobs and attract 1m tourists per year in its final phase.

The Qiddiya project, located 45 km west of Riyadh, is being developed as a city for entertainment, sports and arts, and also has completion date of 2022 for the first phase. With initial infrastructure costs of $8bn, the project will need additional investments to reach its goal of 17m visitors per year by 2035.

Finally, Amaala, a $3bn luxury wellness tourism project, planned for construction near NEOM and The Red Sea Project in the north-west, is scheduled to open its first phase in 2020.

In addition to these, the Saudi leadership has launched dozens of other greenfield projects and revitalised stalled diversification plans from King Abdullah bin Abdulaziz Al Saud's reign. The Economic Cities Authority has been set up to rekindle investor interest in older economic cities projects like King Abdullah Economic City.

Other planned projects aim to address a specific social challenge. For example, to tackle the shortage in affordable housing, the housing ministry has set up the Sakani programme, which aims to provide housing options for thousands of Saudis. To ease congestion in urban areas and address climate change, the High Commission for the Development of Arriyadh (ADA) has signed the world's biggest civil-engineering contract for a six-line metro valued at $22.5bn, while the Ministry of Energy, Industry and Mineral Resources (MEIM) has plans to deploy 9.5 GW of renewable energy by 2023.

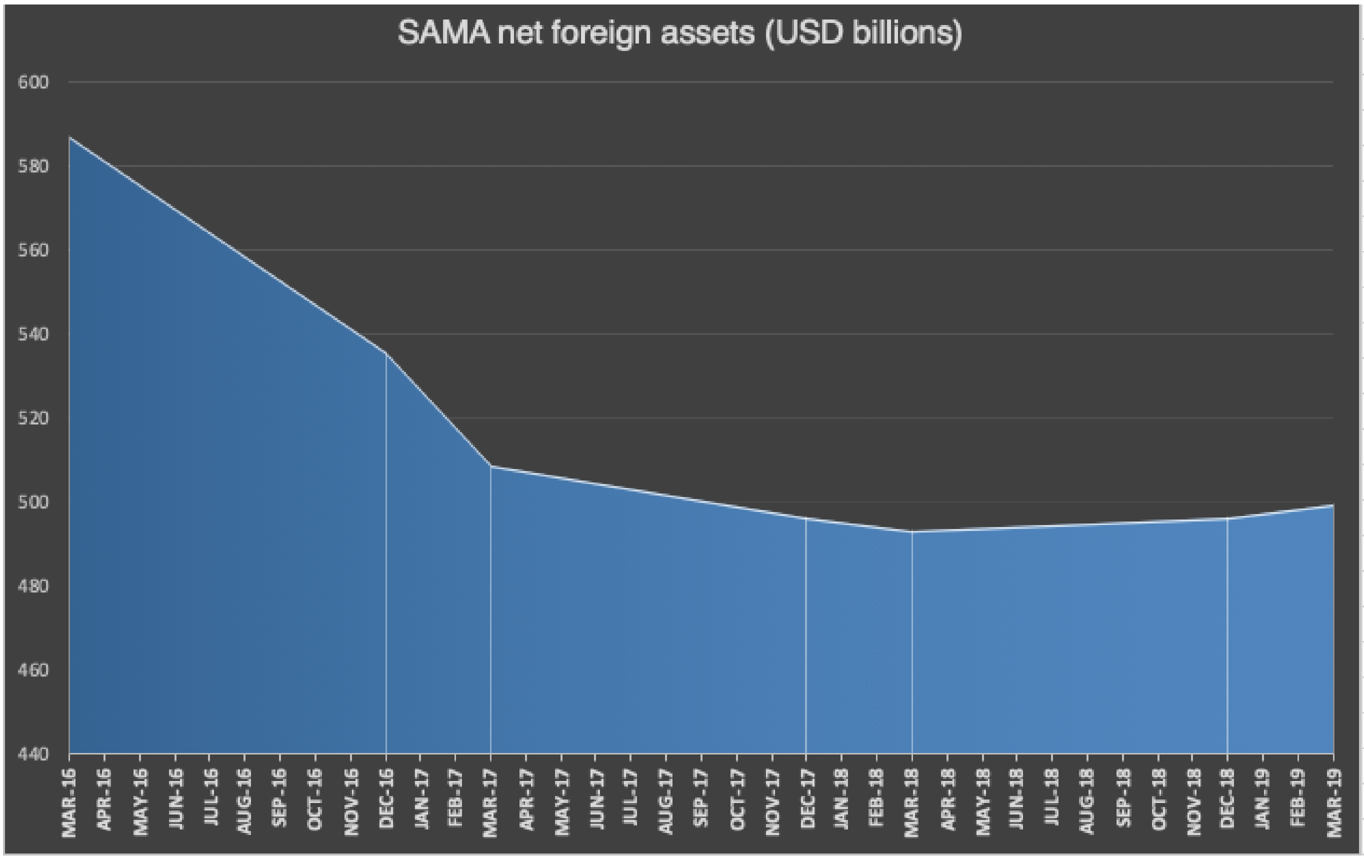


The estimated value (in USD billions) and expected year of completion* of large-scale infrastructure projects, planned or under construction, in Saudi Arabia

*For the highest value projects, the year of completion of the first phase is shown. NEOM is scaled to $250bn to enable a better visual comparison to the value of other projects.

Over-reliance on government spending could stall or derail projects

For now, most of the projects are backed by government spending and funds, and bond issuances, due to a lack of foreign investment and corporate financing. In 2017, the budget increased by 11.6%; in 2018 by 4.3%; and in 2019 by 13%, with 22% of the 2019 budget allocated for infrastructure. To support budgetary growth, the kingdom issued $52bn of debt between 2016 and 2018, and could raise an additional $31.5bn this year alone. PIF itself raised an $11bn five-year loan from 15 banks in August 2018 and put together a new $10bn loan last month, according to local press reports, thus raising the question of whether the fund and the Saudi Arabian Monetary Authority (SAMA) could realistically bump assets while picking up the bills for various diversification projects.

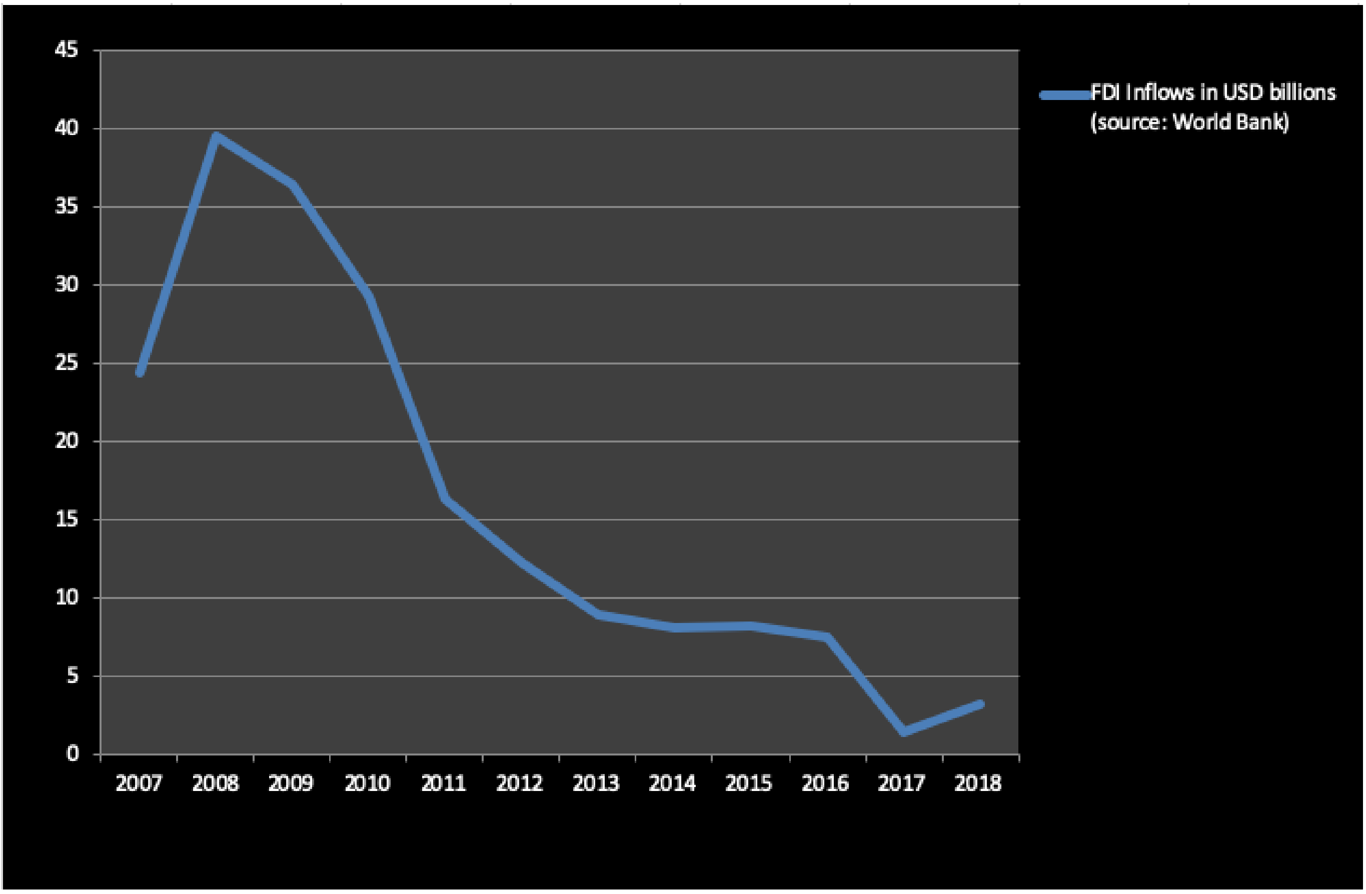


In this era of expansionary fiscal policy SAMA’s assets have dropped by 15% since March 2016

While austerity has understandably been shelved to boost confidence and back Vision 2030, the irony is that government efforts have crowded out foreign investment and overlooked corporate financing constraints.

Growth in the construction sector is expected to rally as a result of the infrastructure plans, but an upturn dependent on state tenders and higher oil prices will only serve to mask, rather than solve, the sector’s more fundamental challenge of poor financial health and low private demand. Furthermore, as rising sovereign debt issues continue to eclipse corporate bonds, the latter will continue to be less attractive on debt markets, exacerbating corporate financing constraints.

Foreign direct investment (FDI) inflows as a percentage of GDP is currently far below Saudi Arabia's 2030 target of 5.7%. Last year FDI represented only 0.4% of GDP – $3.2bn – reflecting not only the globally low levels of investment since 2008 but also the disruptive character and implementation of Vision 2030. While FDI is not the direct objective of Vision 2030, it is indirectly crucial for achieving the overarching goals of knowledge creation, diversification and employment.



Economic transformation requires new approaches in politics and governance

Ultimately, private sector and investor confidence will define the success of Vision 2030. Boosting these will require stronger regulatory frameworks; improved transparency and governance; and the curtailment of political risk to reassure investors that the normative changes linked to Vision 2030 will not lead to unforeseen challenges.

Success will also require a more organic approach to economic diversification than the “build and they will come” strategy behind infrastructure plans. For this to happen, the vast majority of the country, namely the youth, must be encouraged to train in science, technology and other fields that will support the economic transition, and fully endorse new concepts and cultural change.

If multi-faceted reforms aren’t successfully implemented, infrastructure plans on their own will fail to overhaul the economy and Saudi Arabia will run the risk of shelving numerous projects.

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