

POLITICAL ECONOMY OF THIRD WORLD BILATERALISM:  
THE SAUDI ARABIAN - KOREAN  
CONNECTION 1973-1983

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## CHAPTER FIVE

### ENTREPRENEURIAL DYNAMISM AND THE FORMATION OF A BUSINESS CONNECTION

The birth and development of extensive bilateral economic ties between Korea and Saudi Arabia, as we explained in Chapter Four, depended only partly on a set of preconditions conducive to the rise of such bilateralism. Industrial complementarity shaped by the precise timing of development sequencing provided both countries with various economic incentives to cooperate with each other. At the same time, their structural position in the international division of labor and the constraints resulting therefrom, combined with endogenous political and economic factors, had induced political elites of both countries to share a certain strategic consensus in their foreign economic policy which nurtured a feeling of mutual necessity. In this sense, it can be argued that both Saudi Arabia and Korea were endowed with a set of necessary conditions to promote bilateral ties.

However, the mere existence of these necessary conditions alone does not offer a satisfactory explanation for the dynamic interactive processes which evolved around the Saudi Arabian-Korean connection. Certainly these preconditions define the parameters of the structure of bilateral interaction between two countries in terms of

economic and political factors(i.e., comparative advantage and price, structural position in the international economic system and the range of policy choice, and domestic decision-making structure and the level of bilateral preference). It is from these preconditions that we can deduce a set of causal conditions leading to the rise of bilateral ties. Nevertheless, the process-level dynamics and the mechanisms through which this bilateral connection developed are not explained in these preconditions. In this connection, Chapter Two asserted that "the channel and process-level dynamics of inter-South bilateralism are a function of entrepreneurial dynamism (private) in general and the nature of business-state relationship in particular." In other words, since private entrepreneurs carry out economic transactions between two countries,<sup>1</sup> it is essential to examine the role of private entrepreneurship in the evolution of the Saudi Arabian-Korean connection.

Understanding the nature of entrepreneurial dynamism within the bilateral setting is not an easy task. However, Chapter Two identifies four behavioral and structural factors associated with business practices of private entrepreneurs: perception or monitoring capability of new markets, overall entry conditions in new markets, market penetration strategy, and the nature of a business connection as a structural determinant of the effectiveness of market penetration. This chapter's hypothesis is that

the keener the perception of the new market , the more effective the penetration strategy, and the more extensive the magnitude of business connections, the higher the level of bilateral economic transactions. One caveat is in order, however. The entrepreneurial dynamism involved in the Saudi-Korean connection is chiefly one way, rather than two way. While Korean businessmen were anxious to get into the Saudi market, Saudi entrepreneurs were less interested in Korea because their involvement with Korea was solely based on oil exports which did not require entrepreneurial efforts. We focus primarily, therefore, on the entrepreneurial dynamism exhibited by Korean businessmen and on the receptivity of Saudi entrepreneurs.

Korean Entrepreneurial Dynamism: Motivations  
and Perceptions

Private entrepreneurship in Korea is a relatively new phenomenon. Although a merchant class developed during the Yi Dynasty (1392-1910), it could not transform itself into modern entrepreneurs because of various socio-cultural barriers.<sup>2</sup> Modern entrepreneurship in Korea began with the colonial expansion of the Japanese empire. Under Japanese tutelage, a number of native private entrepreneurs began to emerge. With few exceptions, however, they were small<sup>3</sup> and surrogates within the Japanese colonial network. After national independence in 1945 and during the Rhee regime (1948-1960), a new domestic entrepreneurial class

took shape. Under the post-Korean War reconstruction boom and the protectionist umbrella of the Rhee regime's import-substitution policy, they expanded their wealth and business organization substantially. However, many of them disappeared with the regime's collapse because of their backward management structure (based on family ownership) and their low rate of innovation (given their monopolistic or oligopolistic status ( Jones and Sakong 1980: H.Park 1979; M. Park 1981; K. Kim 1976 : Hankuk Ilbo Jan.1 1983)).

It was only after the 1961 military take over that Korean private entrepreneurs began to emerge as a significant entity. With the help of government support and planning, two major groups of entrepreneurs soon dominated the business scene. The first was a mix of old and new business groups induced by the government to take over the basic industries and the manufacturing sector, the essential portion of economic development initiated by Park regime.<sup>4</sup> The other group was composed of new innovative entrepreneurs who took full advantage of the government's stepped up export policy.<sup>5</sup> These two groups later developed into gigantic conglomerates which played a substantial role in manufacturing, export, and domestic marketing. On the other hand, construction firms, which account for the major portion of the Saudi-Korean economic transactions, were insignificant domestic business actors until the Middle East boom. Although they benefited from the post-War reconstruction boom, subcontracting from the

US military present in Korea, the infrastructure construction boom during the 1st and 2nd development plans, and finally from the Vietnam boom, they remained relatively small(OCAK 1982).

As we shall explain below, these three major business groups became active promoters of expanded bilateral ties between Korea and Saudi Arabia. There were a number of factors behind their aggressive penetration of the Saudi market, including domestic constraints, incentives, optimistic market perceptions, and the availability of business links and self-confidence.

Domestic Constraints: The most important reason these groups turned to the Middle East market in general and the Saudi market in particular, was a combination of domestic market saturation and declining external market opportunities. The government's efforts to create a massive major physical and social infrastructure through the 2nd development plan encouraged the formation of a number of new construction firms. When the domestic construction boom ended in the late 1960s and when overseas construction demand declined in the early 1970s with the US pull-out from Vietnam, the construction sector faced serious trouble. Too many firms were looking for too few contracts in an overly saturated market, and intense competition pushed many construction firms to the brink of bankruptcy. Their only exit option was to develop alternative markets abroad. They first explored the

Southeast Asian and Pacific markets, especially Indonesia and Malaysia, but contracts from these markets were small and profit margins were narrow. At this juncture, the Middle East boom began, making Korean firms frantic to take their share (OCAK 1982; Jung 1980:279-289).

Merchandise exporters also faced similar pressure. A relatively small domestic market combined with government export drive policies had driven Korean entrepreneurs to depend excessively on foreign markets. The upswing cycle of international business in the late 1960s encouraged this trend. However, the onset of global recession through the first part of the 1970s and the growing protectionism by the major trading partners (US, Japan, and EC) aimed at the light industrial items in which Korean firms maintained comparative advantage (such as textiles, garments, and steel etc.) created a need to find alternative markets and to diversify export partners.

Apart from these market factors, there was still another crucial constraint which obliged Korean firms to get into the Saudi market. That was the formulation of government policy defining the scope of business operations. On the merchandise exports side, the government enacted a law concerning the establishment of General Trading Companies. Under its terms, in order for domestic exporters to gain the privilege of becoming a General Trading Company, more than 15% of their exports had to go to Middle Eastern countries (Bae 1977:234).<sup>6</sup> This obligatory provision impelled Korean firms to get into the

Middle East market, especially the Saudi market, at almost any expense. A more severe government policy regulated the operations of overseas construction firms. The Overseas Construction Promotion Law in 1975 ruled that if any firms licensed for operation in overseas construction markets failed to win a contract within a certain period from the date of license, their license would become degraded or invalidated (OCPL Article 17, 1975 ). This provision drove Korean construction firms to search frantically for contracts. Given the fact that Saudi Arabia was the largest market with relatively easy entry, it was natural that Korean firms chose the Saudi market.

Incentives: In contrast to these constraints and pressures, there were a number of domestic incentives for market diversification into the Middle East and Saudi Arabia. These were related to fierce export drive policies of the government. From 1965 to the mid-1970s, government export incentives were so extensive and rewarding that getting letters of credit was immediately associated with becoming rich. Incentive policies included waiving import tariffs for raw materials and capital goods for export purposes, tax holidays, and administrative supports to export financing. In addition, losses caused by dumping exports were compensated in the domestic market, while import licenses were tied to export performance. A firm's export volume was the determining factor in setting the level of concessional financing available from government

(Bae 1977:234 ; M. Park 1981:152-3).

Export financing was the most attractive incentive. If exporters received letters of credit from foreign buyers or certified contract documents, they were entitled to export financing beginning with imports of raw materials and extending to exports of finished goods. Contractors received export financing for expenses essential to purchase of construction equipment and to mobilize labor. In the mid-1970s, the interest rates on export financing averaged 9%, far below the market rates.

Both exporters and contractors took full (and even illicit) advantage of this incentive. Instead of allocating export financing to original purposes, they diverted portions into real estate investments and the acquisition of new subsidiaries, the primary source of wealth at the time. The dramatic rise and fall of new export tycoons based on the Middle East market such as Yul San, Won, and Je Se derived from this export financing scheme (M. Park 1981:154).<sup>9</sup> Incentives such as these were also responsible for Korean rush to the Saudi market. The overall volume of merchandize orders from Saudi Arabia was large enough to make hard to notice the illicit diversions<sup>10</sup> of export financing already alluded to.

Optimistic Market Perception: Before the oil crisis, no one paid attention to the Saudi market. Since the quantity of business was small, and monopolized by Levantine and Kuwaiti middlemen, there was no immediate incentive for

Korean firms to move into the area. However, with the oil crisis, its nature of the market drastically changed. In the case of the construction sector, the Saudi market became the most attractive. First, the size and diversity of the market was perceived as offering great opportunities. A Korean businessman recollects of the Saudi market in the mid-1970s as follows:

When the 2nd development plan was unpacked, I was amazed at its size and diversity. The plan covered everything from simple civil engineering projects, massive port construction, and housing projects to plant installations. And the size of the Saudi contracts could not be compared with our previous contracts in Southeast Asia. Let me put it this way: the smallest project cost more than \$10 million, while in Southeast Asia the largest one was less than \$10 million. (interview with N. Sung, Feb. 25, 1983)11

Second, the financial terms of contracts in the Kingdom were extremely attractive. While in other markets ratio of advance payment was less than 10%, the Saudi market paid more than 20% of contract cost as advance payment, considerably easing the financial burdens of the contractors. In addition, import tariffs for construction equipment and materials were almost nil, a flat 3%. Unlike other developing countries, the Kingdom had adopted a liberal foreign exchange policy. No restrictions existed on the remittances of earnings by foreign contractors. On top of all this, despite the famous bureaucratic redtape prevalent in Arab countries, foreign contractors were paid on time in Saudi Arabia.

Meanwhile, merchandize exporters found new market opportunities in Saudi Arabia. Since the Saudi market had little brand loyalty and quality was often deterred by price, they found it an easy market for their goods (Shilling 1975:365). Orders were so huge that even a "one shot deal" could generate a substantial profit and change export rank among Korean exporters.<sup>12</sup> This was particularly true because a great portion of items ordered by Saudi buyers was composed of high volume goods such as construction materials (e.g., cement, plywood, steel, and aluminium) and military software (KIEI 1978; KOTRA 1976). Finally, competition in the Saudi market was not yet difficult. Although US, Japanese, and EEC firms dominated the market, there was still room for Korean exporters in light industry goods and construction materials. In all, this optimistic market perception created a momentum for Korean entrepreneurs which no one wanted to resist.

International Links and Competence: This optimistic market perception coincided with the availability of international links and the growing competence of Korean firms in doing overseas business. In the case of the construction industry, Korean firms had already been exposed to international construction markets through their work in Southeast Asia and through subcontracting works for the American military establishment. In particular, their close association with the US Army Corps of Engineers turned out to be beneficial in a number of ways. First, as

the major emphasis of COE activity shifted from Vietnam to Saudi Arabia, Korean firms could tap the Saudi market as subcontractors through their existing links with COE. Second, a sustaining business relationship with COE had acquainted Korean construction firms with international tender procedures, bidding performance, and American specifications of standards which were commonly required in the Saudi market (OCAK 1982; Jung 1980:284-285).

Besides the formation of business links through the COE, the acquisition of new technologies and expertise in massive human resources management through their participation in the 1st and 2nd plans provided strong confidence in Korean firms. In addition, the availability of construction equipment through their contracting activities in Southeast Asian markets and their transferability to the Middle East gave them another competitive advantage in getting into the Saudi market (OCAK 1982). On the commodity export side, the expansion of export activities and the formation of global business networks helped Korean exporters monitor the Saudi market relatively easily. The changing pattern of comparative advantage in favor of Korean firms in labor intensive items such as light industrial manufactured goods and construction materials also helped to hasten the progress.

#### Entry Conditions in the Saudi Arabian Market

Timely perception of new markets and high motivation

alone, however, do not fully guarantee successful market entry. As classical industrial organization literature suggests, the number of existing entrants, the size of market, the level of demand elasticity, and monopolistic or oligopolistic market structure affect in one or another way the fortune of the new entrants (Shubik 1962; Needham 1978; Baumol 1967).<sup>13</sup> In this sense, therefore, the examination of entry conditions of the Saudi market is essential in order to understand fully how Korean firms entered that market.

Entry conditions into the Saudi market, however, were not only affected by classical market conditions as expounded by theorists of industrial organization, but also by the psychological biases of the Saudi entrepreneurs and the institutional setting characterized by roles played by intermediaries and government. As we shall see, the latter played more important roles in determining the Korean firms' entry. The major entry conditions of the Saudi market can perhaps be best explained in terms of : bazaar mentality, the essential role of intermediaries, the high proportion of public sector in market share, and its oligopolistic structure.

Bazaar Mentality: The term "bazaar mentality," common to Arab and Persian merchants, denotes a way of "thinking of business only in terms of the dealing being made here and now, rather than on any long-range scale."(Africano 1977:30) In other words, quick turnover,

shortage-based pricing, self-styled interpretation of contracts, and strong cost-price conscious attitudes constitute the core of this bazaar mentality. Given the historical evolution of Arab-Saudi traders, this mentality is quite logical. Entrepreneurs in Saudi Arabia have been traditionally merchants and traders, without any industrial base.

One of the salient behavioral features of this bazaar mentality is a tendency to make a "one-shot deal" with high profit margins. Thus, price-cutting becomes the most crucial factor by which Saudi businessmen can maximize their profits. Price-cutting is largely a function of bargaining, which in turn has made Arab-Saudi merchants the toughest of negotiators. Eugene Bird, a keen observer of the Saudi business scene, describes Arab-Saudi businessmen as follows:

Shrewdness, fineness, ability, a taste for secrecy, patience, self-control, perfect knowledge of the files: it took the recent oil crisis to reveal to the stunned Western world the extraordinary talents of Arab negotiators. (Bird 1978:1)

This tough bargaining attitude was particularly visible among the new breed of entrepreneurs who combined a traditional bazaar mentality with modern management techniques such as market research, cost-accounting procedures, and promotion ideas. On the other hand, the bazaar mentality implies dependence on the most traditional business practice founded on personal connections. All

business transactions in Saudi Arabia are highly personalized. Government agencies have personal foundations that logically extend to the contracting area (Shaw and Long 1982:49-50). Thus, big merchants or leading families with extensive networks of personal connections are more likely to win contracts and to sell more goods and services. Saudi merchants with this background often prefer known to unknown foreign firms regardless of quality and price. " If a firm is well known in the Arab world, the contact may be initiated by an Arab firm," Africano observed, " If not, it needs substantial efforts." (1977:30)

This multi-dimensionality of the Saudi's bazaar mentality provided both constraints and opportunities for Korean firms. In terms of bargaining skills, corporate reputation, and of the availability of personal-business connections, Korean firms suffered a great deal in the initial stages of market entry. Furthermore, extremely self-centered interpretations of contracts provisions where in many cases the validity of contracts was contingent upon the protection of Saudi businessmen's interests, increased risk factors to Korean firms (KIEI 1978: 132-135).<sup>16</sup> Despite these constraints, the bazaar mentality had benefits. Korean firms' price competitiveness and willingness to accommodate Saudi's demands on commission rates, fast delivery of goods and services, and price flexibility satisfied many needs and provided new openings into the Saudi market.

The Role of the Intermediary: In the Saudi Arabian business milieu, as in many other Arab countries, the location and utilization of the intermediary is the key to business success. The intermediary in the Arabic social and business context provides multiple services:

<In order> not to be cheated in the market place, in locating and acquiring a job, in resolving conflict and litigation, in winning a court decision, in speeding government action, in establishing and maintaining political influence and bureaucratic procedures, . . . (Patai 1973:232)

Furthermore Saudi Arabia has legally defined the critical role of the intermediary in foreign business operations in the Kingdom. According to Law no.32 of 1930, all commercial transactions including imports and exports, trading and other related commercial activities must be handled by Saudis alone. Foreigners who wish to operate businesses in the Kingdom must find Saudi commercial agents. Until 1977 foreign contractors were allowed to compete freely in the Saudi market without Saudi agents. However, a new tender law set up by Royal Decree no. 14 dated March 27 1977 prohibits such a practice. Accordingly, even in contracting business, foreign firms were obliged to have Saudi intermediaries. Whether it is required by law or purely by cultural necessity, it is almost impossible to do business in the Kingdom without the intermediary usually referred to as an "agent".<sup>17</sup> The right selection of these intermediaries, whether partners or agents, becomes the key

determinant of success or failure for new entrants.

There are different types of agent: commission agents, wholesalers and shipping agents, and tender agents (Mallakh 1982:422-423). The tasks and duties of each intermediary are different. While commission agents and wholesalers usually arrange orders for the products from Saudi merchants, set price conditions, and expedite payments, tender agents assume broader responsibilities: speedy collection of contract information, passing on foreign firms' prequalification requirements by clients, detecting clients' projected price of the contract and number of prospective competitors before the tender, inviting foreign customer to the tender and even to the final negotiation after the tender, negotiating advantageous prices for customers, inserting advantageous clauses in the final contract on behalf foreign customers, and finally providing political leverage in clearing and lubricating bureaucratic procedures concerning any other problems raised by clients (Choi 1981:47-51 ; Nehemkis 1975:16-18; Mallakh 1982:442-3).<sup>18</sup> Compensation for these services rendered by agents is a commission or agent fee. It ranges from 1% to 5% in Saudi Arabia. By the Tender Law of 1977, the maximum commission should not exceed more than 5% (Shaw and Long 1982:52-53). As shall be discussed below, however, the rate is not fixed, but variable to a great extent.

This timely and proper selection of Saudi intermediaries was one of the most serious obstacles to

Korean firms' entry into the Saudi market. Since these agents, once chosen, cannot be easily replaced, the first choice becomes the crucial factor affecting the success or failure of any venture. Selecting Saudi local partners usually involves four major channels: 1) school ties (in case of the older generation, for example, the Cairo University connection, while for the younger generation, the American University in Beirut or US and UK universities); 2) political connections; 3) global business networks; and 4) direct search in the field.<sup>19</sup> Among them, the most important channels are school ties and political connections. Although locating sponsors through global business networks was practiced, it was impersonal and thereby weakened Korean firms in bargaining. Most Korean firms relied on the fourth option, i.e., random-direct search in the field, but it was the most risky. This lack of connections in the initial stage of market penetration made Korean firms rely on non-conventional business practices such as unacceptably high commissions and even hybrids of bribery and extortion.

Public Sector Concentration: The third major characteristic of the Saudi market was a high level of public sector concentration in its structure. From an organizational point of view, the Saudi Arabian economy is a laissez-faire, open economy. However, more than 90% of its commodity and contract demands came from the public sector. In view of development plans discussed in Chapter

Four, this concentration of commodity purchases and tenders in the public sector was understandable. In fact, the government fully utilized this public sector concentration in the domestic market for its political purposes (Thompson 1982:12 ; Salameh 1980:18). As Shaw and Long correctly observe, "one of the principal ways the government distributes its wealth is through public tender, not only for major purchases but for small ones as well." (Shaw and Long 1982:54)

This public sector concentration, however, had adverse effects for Korean firms. While Western industrial countries, notably the US, maintained a substantial political influence over the Saudi government through military aid and technical cooperation, Korea's diplomatic influence in the early stages was insignificant. In addition, government projects needed considerable political connections which Korean firms apparently lacked in this period. Although one Korean firm (Samwhan) was the lowest bidder for two major projects in 1974, the Saudi government rejected this offer and invited a Western firm whose bid was higher.<sup>20</sup> Although the rationale behind this rejection was that the Saudi government could not judge the Korean firm's performance capability, the real cause was the lack of political connections and the relative weakness or immaturity of the Korean government's relationship with the Saudi government.

Oligopolistic Structure: As table 3-3 illustrates, over 90% of the Saudi merchandize market was monopolized by US, Japan and EEC countries. The contracting market was similarly dominated by Western firms. In 1974, for example, immediately after the oil crisis and the onset of the development boom in the Kingdom, US firms won 2.1 billion worth of contracts from a total \$2.9 billion, a 73.2% market share. As shown in table 5-1, US domination of the Saudi contracting market continued. During 1975-1977, US firms won almost half (45.2%) of the Saudi construction market, while EEC countries accounted for 32.5%.

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table 5-1

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The US dominance was due to many factors. For example, the 2nd plan itself was drafted by a US consulting firm, the Stanford Research Institute, while a great portion of construction work came from ARAMCO and COE (Shirreff 1979:4-6; Whelan 1981:34)<sup>21</sup>. Furthermore, two major US firms, Bechtel and Ralph Parson, won the consulting contracts on the multi-billion dollar Jubail and Yanbu industrial city construction projects. The formation of US business interests in terms of political arrangements (e.g., COE) and of consulting works (Bechtel, Ralph Parsons, and Standford Research Institute) created enormous opportunities for American firms. The same can said for

Table 5-1 Country Composition of the Saudi Construction Market (1975-Feb. 1977)

Unit: US\$ million

	1975	1976	Feb. 1977	Total	Ratio (%)
U.S.A	1,785.7	10,026.0	800.0	12,611.7	45.5
W.Germany	510.5	2,773.6	54.6	3,338.7	12.0
Netherlands	556.3	1,325.0	537.0	2,418.3	8.7
France	95.0	1,137.9		1,345.4	4.9
U.K	47.7	1,099.9		1,147.6	4.1
Italy		683.7		683.7	2.5
Japan	276.4	23.6		300.0	1.0
Others <sup>1)</sup>	1,293.3	4,545.6	37.6	5,876.5	21.2
total	4,564.9	21,615.3	1,541.7	27,721.9	100.0

1) By "others" means indigenous firms, Korean, Taiwanese, Turkish, and other new entrants in the Saudi market

Source: KIEI, Report on Saudi Arabia (Seoul: KIEI, 1977) p.16

major European firms.

This barrier, however, was a mixed blessing for Korean firms. Unable to be principal contractors, Korean firms had increased opportunities to do subcontracting work for Western firms. Although profit margins were low and working conditions were not favorable under the subcontractor status, opting for subcontracting jobs at least guaranteed market entry by Korean firms.

Entrepreneurial Dynamism: Patterns of Korean Firms' Market Penetration Strategy

The conditions of the Saudi market described above basically defined the parameters of the Korean firms' corporate strategy to enter the Saudi market. In order to overcome the obstacles endemic to the oligopolistic market structure, Korean firms demonstrated more flexible approaches, alternating between subcontracting and joint-ventures. To overcome the various barriers imposed on new entrants, Korean firms had to be competitive in price, more aggressive and more willing to take risks. Further, in order to strengthen their business connections, Korean firms offered lucrative incentives to Saudi intermediaries. But, to compete with Western firms and to convince the Saudi government of their capability, they badly needed strong support from Seoul.

Flexibility: Compared to American and European firms, Korean firms were extremely flexible in their market

approach. They did not insist on highly profitable principal contractorship. As opportunities arose, Korean firms alternated their contract types. For example, Korean firms took full advantage of their American connection in the early period by being the latter's major subcontractors. During 1974-1980, 121 projects (amounting \$4.2 billion) out of total 565 undertaken by Korean firms in the Kingdom came from ARAMCO and COE in the form of subcontracting (MOC 1982). In other words, 19.4% of total contract amount originated from these American sources. As table 5-2 indicates, however, this early subcontracting practice changed into joint-ventures with local firms. In pre-1976 period, there was only one joint-venture. But as the Saudi government pursued a policy of Saudi-ization

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Table 5-2

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favoring local firms, Korean firms immediately responded to this changing market environment by pushing for more joint-ventures with local firms. As a result, by 1982, joint-ventures sharply increased from 6 (7.1%) to 43 (26.3%), while principal contracts and subcontracts declined from 53.4% and 39.5% in 1977 to 43.8% and 29.8% in 1982 respectively. This Korean adaptability helped them overcome the initial barriers of this oligopolistic market structure and the subsequent Saudi-ization policy.

Table 5-2: Korean Construction Business by Contract Type (selected years)

type/year	<u>Unit:US\$ million</u>				
	pre-1976	1977	1979	1980	1982
Principal Contract	48 <sup>1)</sup> (69.5) <sup>2)</sup>	46(53.4)	64(52.4)	76(53.5)	72(43.9)
Sub-Contract	20(28.9)	34(39.5)	32(27.0)	37(26.0)	49(29.8)
Joint-Venture	1(2.6)	6(7.1)	26(20.6)	29(20.5)	43(26.3)
total	69(100)	86(100)	122(100)	142(100)	164(100)

- 1) There are two ways of calculating the ratio of contract type: that is, volume(or amount) and number of projects (or contract). The figures in this table indicate the number of contracts(i.e., frequency)
- 2) The figures in brackets indicate percentage.

Sources: Ministry of Construction(Korea), Korean Embassy in Jeddah, and Overseas Construction Association of Korea.

Price-competitiveness and risk-taking: Survival in the Saudi market depends heavily on price. Regarding this, Abdul Rahman al-Zamil, Deputy Commerce Minister of the Kingdom, noted the following : " the secret in the Saudi market is cost control. This market fluctuates all the time. Saudis understand the price and costs."( MEED July 1981:33) Indeed, competitive pricing was the key not only to winning contracts and selling more goods, but also to attracting influential Saudi intermediaries. How competitive were Korean firms? Figures in table 5-3 offer a clear picture. The author selected three sample projects

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table 5-3

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in which Korean firms were engaged, and compared their bidding prices with the 2nd lowest Western bidders in the same projects. The findings were surprising. In case of the Yanbu de-salinization plant infrastructure project, the Korean firm's (Dong Ah) bid price was almost half the second lowest price (British Balfour). In another project (Islamic University B.O.Q construction project), while the price disparity between the lowest bid price by a Korean firm, Lucky Development, and the second lowest bid by a Dutch firm, Ballast Nedam, was around 30%, the actual difference reached \$74.3 million. In case of the Jubail industrial port project, Hyundai's bid price ( \$931

Table 5-3: Comparison of Bidding Prices  
between Korean and Western firms

Unit:US\$ million

Project Title	Korean lowest	Western second lowest	Disparity
Royal Executive Office and Cabinet Council Office	61.8 (Miryung)	84.3 (Taisei)	22.4(73%)
Infrastructure construction for Yanbu de-salinization plant	16.6 (Dongah)	31.6 (Balfour)	14.9(52.6%)
Construction of Islamic University (Imam Mohammed Bin Saud) B.O.Q.	187.2 (Lucky)	261.6 (Ballast Nedam)	74.3(71.3%)

Sources: Feb.8 1980, MEED/ March 25, 1980 Saudi Business/  
Oct. 12 1980 MEED/ Oct. 5 1980, Saudi Business

million ) was said to be almost \$500 million less than the  
24  
second lowest price by a Dutch firm.

Where did this price competitiveness come from? According to a Korean engineer experienced in the Saudi market, a large portion of such price cutting came from mistakes in project estimation stemming from a lack of expertise in large projects.  
25  
Apart from this element of miscalculation, however, there were a number of other factors directly responsible for price cutting. Cheap labor cost, sharp reductions in indirect overhead costs, and low profit margins are among the key factors responsible for price competition.

In the case of labor costs, as of 1977, the monthly base salary for Korean skilled labor was \$312, almost one fourth that of Western workers and one half that of local Arab workers. The gap was much higher in the category of engineers and managers. Korean engineers and managers lived on work site camps along with the workers, thus reducing additional overhead costs, while Western managers and engineers were paid five to six times higher and were provided with luxurious living living accommodations. The Korean advantage in labor cost is well reflected in Table 5-4. While Western firms' labor costs occupy more than 30% of total project costs, Korean firms' costs remained at the 20% level through the entire period of business operation in the Kingdom. The share of labor costs out of total project cost was a mere 12.4 % in the initial stage (1974-

1976). Although labor costs gradually increased over time from 12.4% to 23.6% in 1980, cost control from this labor sector was a crucial element in enhancing Korean firms' competitiveness.<sup>26</sup> It is also true that the productivity of Korean workers was very high, even compared to Western workers.

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table 5-4

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Another major cost control factor came from the sharp reduction in indirect overhead expenses. For example, for each Korean worker with the base salary of \$312, monthly overhead cost was about \$350, which included food, accomodation, insurance, etc. Korean firms cut these overhead costs substantially by shortening project duration. In the case of the Jubail Industrial Port project, Hyundai completed all the work two years ahead of schedule. Using a variety of incentives and fully utilizing the work force for 24 hours with three shifts, Korean firms not only reduced indirect overhead cost, but also saved on wages. This comparative edge in labor and overhead costs, coupled with decreasing costs for equipment ( 27% in pre-1976 to 6.5% in 1979), helped Korean firms function competitively in the Saudi market.<sup>27</sup>

In addition to effective cost control, the aggressive risk-taking attitude of many Korean entrepreneurs accounted for a large measure of their success in the Saudi market.

**Table 5-4: Changing Composition of Project Costs: 1973-1980**

type/year	1973-1976	1977	1978	1979	1980	1973-1980
Equipment cost	27.0 <sup>1)</sup>	16.4	9.9	6.5	6.5	9.0
Costs for construction materials	31.8	42.8	43.9	36.7	35.3	38.2
Labor cost	12.4	16.8	16.8	22.2	23.6	20.6
Other <sup>2)</sup> Expenses	28.8	24.0	29.4	34.6	34.6	32.2
total	100.0	100.0	100.0	100.0	100.0	100.0

1) percentage

2) Other expenses include agent fees and operational costs as a whole.

Sources: Overseas Construction Association of Korea and Ministry of Construction.

Both the commodity and the construction market in Saudi Arabia are risky because of institutional barriers and project size. The scope of each project was so large that a single failure could push small to medium sized firms, like those of Koreans, to the brink of bankruptcy. Despite these risks, Korean firms showed themselves ready to take chances and in addition, willing to accept low profits. In general, conservative Western firms were not interested in any projects unless profit margins of 30%-40% were guaranteed. Delayed payments, bureaucratic red tape, abrupt changes in design etc. were anathema to many Western firms, and in order to protect themselves, they insisted on high profit margins. However, Korean firms were ready to accept 20% profit margins and in certain cases, less. As we shall see in Chapter Six, in the early 1980s, these profit margins dropped to 10%.

This risk-taking attitude was also apparent in commodity exports. In order to penetrate the Saudi market, Korean exporters utilized a wide range of tactics. Stock sales were frequent even by General Trading Companies. In certain cases, Korean exporters shipped large quantities of cement, steel, and plywood to Jeddah without firm contracts. D/A based letters of credit (sales on credit) were welcome. Such behavior produced winners as well as losers. Yulsan, Seje, and Won were superstars of the new business conglomerates born in the Middle East boom and among those that fell apart. Apart from price-

cutting based on cost control and risk-taking, the effective decision-making structure and the persistent market approach of the Korean entrepreneurs facilitated their entry into the Kingdom to a great extent. One of the salient aspects of the Saudi contract market is that a great portion of its tenders are either negotiated open tenders or nominated. Open competitive tenders, common in the US contract market, constitute less than 10% of total (J. Park 1982). This kind of tender market requires in many cases immediate, yet authoritative decisions by top executives of the bidding companies. Western firms were weak in this area because the top men in the field need final approval from headquarters. Korean firms, however, were different. In most cases, owners of firms resided in the field and made decisions immediately.

In addition, Korean entrepreneurs were patient and persistent in locating opportunities in the Saudi market. While Western firms shunned the uncertain market Korean entrepreneurs took the opposite course (Arab Construction Feb. 1980; Shireeff 1976). In order to obtain a first contract, owners of Korean firms often visited the Kingdom more than 10 times with an entourage of 5-10 engineers. Although the costs of developing the Saudi market were high and uncertainty always prevailed all the time, Korean entrepreneurs persevered. H.S. Choi, president of a now successful Korean construction firm, recollected some early difficulties in the following manner:

Getting the first business chance in the

Kingdom was something like gambling which I was not accustomed to. I visited Saudi Arabia twelve times to obtain the first contract. Each visit cost our firm more than \$20,000. In other words, we spent more than \$200,000 to win one single project without any guarantees. That amount almost equaled one third of our total assets. Hunting jobs in Saudi Arabia almost pushed our firm to bankruptcy. Yet, we did our best with patience. That paid off later. (interview Feb. 22, 1984)

Non-Conventional Business Practices: Perhaps the most striking aspect of Korean firms' penetration strategy is related to their wide use of non-conventional business practices. The concept of non-conventional business practice is vague, and hard to define. However, it is defined here as patterns of business practices which deviate from classical market penetration strategies founded on fair trade, such as effective management techniques, creative corporate strategies, and innovations in production lines and sales etc.. As shown in table 5-5, these non-conventional business practices are related chiefly to some form of "political" payment, whether it be lawful payment, a bribe, extortion, or their hybrids. In the Arab Middle East context, non-conventional business practices (by Western standards) are an inseparable part of the rise and fall of business firms. As Braudel observes, "the political payment is a pervasive feature of Middle Eastern life. Four centuries of Ottoman misrule fastened the habits of corruption on the Islamic world." (1973:693)<sup>31</sup> Indeed it is deeply embedded in the social and cultural fabric of these countries, and Saudi Arabia is no

exception.

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Table 5-5

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"Political" payments or non-essential payments from point of view of modern business management are indispensable for business success in many parts of the world (Fisher 1967:237-38; Jacoby, Nehemkis, and Eells 1977; Lacey 1981). The reason for this is : to find reliable intermediaries who are close to decision-makers; to obtain or retain business; to lubricate the bureaucratic machinery; to induce official actions in relation to business interests; to avoid harassment; to reduce unnecessary political risks; to enhance the seller's image (refer to table 5-5).<sup>32</sup> The major recipients of such "political payments" or objects of non-conventional business practices chiefly involve agents, finders, consultants, and most importantly government officials regardless of their functional branches (executive, legislative, and judiciary) or rank (senior or junior). The mode of payment ranges from making contributions to charities of the payee's choice to outright payments to principals.<sup>33</sup>

How did Korean firms handle such non-conventional practices? Contrary to public perception, Korean firms opted for lawful payments. As defined by the Kingdom's law, Korean firms paid fees or commissions to their agents,

Table 5-5: Classification of Non-Conventional Business Practices by Korean Firms

- 
1. By Legal Type
    - 1) Lawful Payment
    - 2) Bribery
    - 3) Extortion
    - 4) Hybrids of bribery and extortion
  
  2. By Type of Recipient
    - 1) Agents, finders, consultants and representatives
    - 2) Major government officials ( executive branch)
    - 3) Minor government employees
  
  3. By Mode of Payment
    - 1) Cash
    - 2) Overbilling of sales with kickback to the buyer
    - 3) Payment of travel and entertainment expenses
    - 4) Making contributions to charities of the payee's choice
    - 5) Purchasing or renting properties from the payee at an inflated price
  
  4. By Purpose of Payer
    - 1) Obtain or retain business
    - 2) Lubricate bureaucratic redtapes
    - 3) Induce official action
    - 4) Avoid harassment
    - 5) Reduce political risks
    - 6) Enhance seller's image
- 

Note: This classification is based on that developed in N.Jacoby, P. Nehemkis, and R.Eells, Bribery and Extortion in World Business (New York: MacMillan Publishing Co., 1977) p.88

sponsors, and finders. What distinguished them from Western firms was that the Koreans paid more. The customary international rate of commission is approximately 5% which drops further if the project amount exceeds more than \$100 million.<sup>34</sup> Until the 1977 Tender Law was enacted, there was no legal limit to the commission rate, and Korean firms desperate to win contracts paid up to 30% to 40% of contract amount as commission. Even after the enactment of the Tender Law which set the maximum 5% limit, Korean firms were willing to pay more than 5% illicitly. For example, Hyundai is known to have paid fees in excess of 15% to its Saudi sponsor, al-Bilad Co. in late 1978 in order to win an \$80 million contract for the erection and operation of an aggregate crusher and asphalt batch plant at Riyadh's new international airport project (ENR Nov. 15 1979). Korean firms found it necessary to overpay agent fees in order to locate influential intermediaries and thereby to obtain business. Such overpayments were quite difficult to detect<sup>35</sup> by the authorities

A less pervasive but more controversial business operation practiced by some Korean firms was sporadic reliance on bribery and extortion in order to obtain business by changing the outcomes of a tender, or to induce official actions as well as to lubricate bureaucratic procedures. Since this type of business practice is highly clandestine and sensitive, it is not easy to find evidence to prove this point. The author nevertheless

attempted to document such practices of one Korean firm in order to determine a corporate strategy in this area.

The case in point is Hyundai Construction Company, Korea's largest and the world's 8th largest contractor in 1981, and the firm credited with opening the door to the Saudi market for Korean firms. Hyundai's Saudi operation was successful, but not without scandals and negative publicity. The problem started with the first major contract, a \$931 million job at the Jubail industrial port, which although won by the lowest bid, depended on an influential intermediary. When the firm got the job, its engineers found that the contract could bring about devastating losses to the firm. Hyundai's tactic was first to cut its commission to the intermediary. In order to protect itself, the firm also claimed a large extra costs, reportedly close to \$100 million. In order to induce official approval of this claim, Hyundai allegedly agreed to pay a \$22 million kick-back to two top officials in the Saudi Arabian port authority. As it turned out, the claim was not approved, and the pay-offs were never made, since the scheme was disclosed and an official investigation was made by the Saudi government (ENR Nov. 15 1979 and interview). But this kind of kick-back was reportedly common to most foreign firms doing business operation the Kingdom. Korean firms are said to have relied heavily on this tactic to cover up their price dumping.

However, more serious problems came from two well publicized bribery scandals which led to the arrests of top

Hyundai executives. One involved an attempt to change the tender outcome for rural power projects by influencing Dr. Al-Qusaibi, the Industry and Electricity Minister. The other was related to an attempt to win contracts on the multi-billion dollar military cantonment construction at Tabuk by co-opting Major Faisal, a senior official of the Military Works Directorate within the Ministry of Defense and Aviation. In both cases, top Hyundai executives brought large cash payments to the above officials' offices \$2 million and \$2.5 million respectively (ENR Nov. 15, 1979; MEED Nov. 7, 1979; Arab Construction Feb. 1980; Interviews). While the former ended with the arrests of those top executives, the latter attempt bore serious consequences for the entire firm. This was particularly so because the attempted bribery took place at the height of the Saudi government's campaign to eradicate corruption. 37

A major local newspaper unusually reported the Saudi government's decision on Hyundai's bribery attempt in the following way:

Royal sanctions have been given stopping the award of any work to Hyundai of Korea, and stopping the signing of any contracts with this company, either directly or indirectly, until investigations are completed concerning accusations against the company. This instructions came in circular distributed to all ministries and state organizations, asking them to abide by the ruling. (al-Jazirah Oct. 20, 1979)

Penalties were severe. Hyundai was banned from the Saudi market for nearly two years (1980-1981). And the

firm lost more than \$ 1 billion worth contracts in hand, in addition to the Saudi-Bahrain causeway project, which were about to be awarded. Hyundai's efforts to re-enter the Saudi market included inviting a number of Saudi dignitaries and journalists to Korea, and it contributed some \$200,000 for the purchase of a landsite for the construction of an Islamic College in Korea sponsored by Prince Naif, the Saudi Interior Minister, who was in charge of the Hyundai investigation. At the same time, the firm mobilized the Korean government to help lift the Saudi ban. The Hyundai issue occupied the top agenda of all official meetings between the two governments until the ban was lifted in late 1982.

The Hyundai episode was not unique. It has been known that the utilization of unlawful business practices was quite common among Korean firms. Though small in size and therefore less noticed by the media, most Korean firms have been engaged in such practices. While many American firms suffered from the enactment of the Foreign Corrupt Practices Act (FCPA), a fall-out of the Lockheed scandal, Korean firms explored their ways into the tough market by maneuvering these non-conventional business practices.

Consolidating Government Supports: As we shall discuss in Chapter Six in detail, Korean firms have depended to a great degree on various government back-ups. Since most firms were small in size, they needed government support to obtain bank guarantees from commercial banks. In order for

them to remain competitive, they needed tax benefits, particularly from corporate and income taxes. When stiff overcompetition and other conflicts of interests ensued beyond their control, they expected the government to intervene and to resolve the conflict. In addition, they needed political and diplomatic support from the government. All these demands and expectations could not be satisfied automatically.

In order to deal with these problems and issues, Korean firms engaged in overseas construction formed an interest group called, the Overseas Construction Association of Korea in 1977. Within a short period time, the association emerged as one of the five most powerful business lobby groups in Korea.<sup>40</sup> Although the association is technically under the supervision of the Ministry of Construction under the corporatist setting, its demands and proposals ranging from financial matters to labor management have been well reflected in government policies. As table 5-6 indicates, in the initial stages of the entry in the Saudi market (1977 and 1978), almost all of the proposals and policy recommendations made by the Association were accomodated by

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Table 5-6

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the government. Although the rate of acceptance by the government sharply dropped to the level of 50% after 1979, on the whole, the government has been very responsive to

Table 5 - 6: OCAK's Lobby Activities

(Unit: case)

Type	year	'77	'78	'79	'80	Total
Financial and Insurance-related policy proposals		3 <sup>1)</sup>	8	12	15	38
		(3)	(7)	(6)	(7)	(23)
Administrative proposals		2		4	2	8
		(2)		(2)	(1)	(5)
Labor related proposals		2	8	10	4	24
		(2)	(6)	(4)	(-)	(12)
Equipment re-related proposals		2		6	3	11
		(2)		(4)	(2)	(8)
Others			1		3	4
			(1)		(3)	(4)
Total		9	17	32	27	85
		(9)	(14)	(16)	(13)	(52)

1) Figures in upper row indicate the number of policy proposals and recommendations made by OCAK, while those in brackets illustrate the number of proposals accepted and implemented by the government.

Source : OCAK, present status of the OCAK  
(Seoul: OCAK, 1981) p. 31 in Korean.

the demands and needs of the Association. These positive responses largely emanated from the government's need to maximize foreign earnings through the overseas construction sector. However, it cannot be denied that collective actions of this interest group constituted a key element in consolidating the government support, which in turn helped Korean firms to be successful in the Saudi market.<sup>41</sup>

The Saudis' Entrepreneurial Receptivity and the  
Formation of Business Connection

As shown above, Korean firms were competitive in price, and made more concessions in terms of agents' fees. They were patient and persistent in locating their middlemen(wasta) and securing contracts. In addition, they were efficient and timely in carrying out contracts. This positive penetration strategy paid off for Korean firms by altering earlier Saudi perceptions of their value and seriousness. Old and new merchants, businessman-turned technocrats, princes and other highly placed persons began to show a more positive attitude toward the Koreans. The result was a much more enduring business connection between Korean firms and Saudi business elites, which was instrumental to the continuation of Korean business success in the Kingdom.

As of 1982, there were 236 agents for 50 Korean construction firms,<sup>42</sup> and 58 agents for 46 Korean exporters. In the case of construction firms, each firm

maintained an average 4.7 agents. However, some firms hire more than 10 agents as a way of diversifying their business contacts and increasing their maneuverability. Hiring multiple agents contrasts with their previous tendency to select one agent on an exclusive basis, so that the latter can cover all the contract activities in the Kingdom. Due to various drawbacks and a change in Saudi policy,<sup>43</sup> many Korean firms adopted a multiple agent policy. Nevertheless, some Korean firms still rely on a single agent for the entire Saudi market. In this case, the local agent is usually very influential. Daelim, Samwhan, and Keongnam, the three most successful Korean firms, still retain the agents who were hired at the time of market entry.

For example, Daelim's local agent is Gaith Pharaon, president of Saudi Development and Research Corporation. Along with Khashoggi and Ojjen, Pharaon is one of the most successful new entrepreneurs in the Kingdom. His wealth results from his entrepreneurial innovation and his father's political connection.<sup>44</sup> Daelim's first contact in the Kingdom was Pharaon with whom they set up a joint-venture REDEC-DAELIM in May 1974. The contract period was initially set for 10 years with an 8% agent fee, which is quite unusual. Normally, the contract period does not exceed two years. However, Pharaon was so influential and well placed that Daelim's decided to retain him over a longer period of time. That decision paid off. The Redec-Daelim virtually monopolized maintenance contracts

originating from the ARAMCO with 50-60% profit margins.

A similar example can be found in the case of two other Korean firms, Samwhan and Keongnam. Samwhan's local agent is Fahd Hussein Shobokshi of General Agencies Corp., who maintains a close relationship with major Farsi of Jeddah city and owns two of the most influential newspapers in Jeddah, Saudi Gazette and Okaz. With the help of Shobokshi, Samwahn virtually swept contracts originating from the city of Jeddah and its vicinity. Again, the agent's political connection and influence induced the firm to continue to use him exclusively. For Kyungnam, its agent is Yousif Nazer of Nazer Enterprises, who is a brother of the Planning Minister Hisham Nazer. The agent's personal background combined with his performance also induced the firm to retain Nazer as its sole agent.

As the case of these three companies implies, Korean firms, like many other Western firms, tend to search for the more powerful, well connected, and aggressive agents in the Kingdom. Since the Tender Law of 1977 limited the number of foreign agencies permitted to Saudi citizens to the maximum of 10, Saudi firms do not represent more than 10 firms. However, within that legal limit, they tend to have as many as foreign representative. For example, Saudi Fal Establishment, which is believed to be backed up by prince Muhammad bin Fahd, the fifth son of present King, represents seven Korean firms including Hyundai. Another Saudi firm, Enany Construction and Trading Est., also

represents five Korean firms. This firm is also known to be supported by prince Faisal bin Khalid, the eldest son of late King Khalid. This concentration of agencies in a selected number of local firms is generally believed to be a result of their powerful position in the Saudi business and political community.

Having dealt briefly with the pattern of agent selection by Korean firms in the Kingdom, we turn now to the nature of the Saudi-Korean business connection. For example, what are the social and political characteristics of Saudi agents for Korean firms? How do they influence business outcomes in behalf of Korean firms? As argued in the previous sections, the degree of business success in the Kingdom is largely a function of this business connection. The firms which are well connected by influential intermediaries are likely to win more contracts and to face less bureaucratic and political redtape and risks. Thus, the nature of the business connection becomes an important indicator allowing us to measure the level of business success in Saudi Arabia.

According to the interviews conducted by the author and as a result of an extensive document search, some 168 Saudi agents, who had been hired by 42 Korean firms from 1974 to 1982, could be identified. The following discussion is limited, therefore, in the sense that it does not cover the entire range of agents in the Kingdom. Since the number of agents covered in this research represents more than two

thirds of total (particularly when we consider the overlapping of agents), however, findings in this section can give us a fairly accurate picture of the Saudi-Korean business connection. Table 5-7 summarizes the author's findings in this regard.

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Table 5-7

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Contrary to popular belief that Saudi wealth is monopolized by royal family members, the majority of the local agents for Korean firms came from new middle class merchants. They represent exactly one half of the total agents in the Kingdom, accounting for 84 out of total 168 agents identified in the field research. This new middle class merchant is something of a new phenomenon. Given the highly personalized business style in Saudi Arabia, they must be connected in one way or another to the core of political power. As a matter of fact, some of them represent interests of royal family members and other highly placed governmental officials. However, the author's findings through the field survey indicate that a great majority of them are highly motivated, well educated, and new to the market. The emergence of this class as a counterpart for Korean firms can be attributed to two major factors. One was the enactment of 1977 Tender

Table 5-7 Saudi Agents for Korean Firms 1)  
Classification by Social Status

Social Origin	Number	Agent Type		Commission Rate			Reference
		Ex	Case <sup>2)</sup>	4% <sup>3)</sup>	5%	N.A.	
Royal Family	9(5.3%)	3	6	4	3	2	Active prince agents are few. Among them, princes Khalid, Muhammad, and Faisal are active
Traditional-Big Merchants	23(13.6%)	4	19	9	10	4	Besides old merchants such as Alireza's, jamjoom's and Sulayman's, new big merchants such as Kashoggi, Pharaon, and OjjeH are inserted here
Technocrats	31(18.4%)	11	18	11	15	6	By technocrat is meant to ex-bureaucrats and the firms which are tied to incumbent bureaucrats by family ties and personal friendships. By law incumbent technocrats are not allowed to practice business
New-Middle Class Merchant	84(50.0%)	10	74	31	44	6	Many merchants in this category have ties to royal family members and gov't officials. However, those whose ties with above actors cannot be verified are classified here
Local-tribal leaders	21(12.7%)	2	19	12	8	1	Local and tribal leaders are defined here in terms of those who do not have nation-wide business operation limiting themselves to local business interests
Total	168	32(19%)	138(81%)	67(39.8%)	82(48.9%)	19(11.3%)	

1) It is known that there are at least 230 Saudi agents for Korean firms as of 1982. However, more than 22 agents are overlapped. The total number derived here(168) is less than the actual number of agents not only due to this overlapping but also due to the unavailability of data.

2) "Ex" denotes exclusive agent, while "case" denotes case-by-case agent.

3) 4% commission rate refers to those rates which fall below 4% ranging from 1% to 4%. Rate above 5% usually refers to those rates whose terms are not specified.

Sources: Data obtained here are mainly from personal interviews with Korean construction companies in the Kingdom and Saudi firms during this author's visit to the Kingdom 1982 and 1983. Data for some companies were obtained during this author's visit to Korea in 1981, 1982 and 1983.

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Sources: Data obtained here are mainly from personal interviews with Korean construction companies in the Kingdom and Saudi firms during this author's visit to the Kingdom 1982 and 1983. Data for some companies were obtained during this author's visit to Korea in 1981, 1982 and 1983.

Law which prevented the monopolization of foreign agencies by limiting its number to the maximum of 10. In fact, this law, which was an explicit attempt by the Saudi government to trickle down its oil wealth to middle and low social strata people, allowed well motivated young Saudis to engage themselves actively in this kind of business. Another major factor was the Saudi government's push for the Saudi-ization plan. This plan, which was originally designed to restrict the influx of foreign manpower, paved the way for these new middle class merchants to get into contract business by giving them special privileges in many areas.<sup>46</sup>

Surprisingly, the second largest number of agents came from the technocrat class. Since technocrats currently in office are not allowed by law to practice business, this category represents chiefly former bureaucrats and the firms or agents who are closely tied to incumbent technocrats. According to the author's survey, 18.4% (31) of all the identified Saudi agents for Korean firms come from this technocrat class (refer to table 5-7). As Palmer and Hegelan (1984)'s recent study shows, there was a trend for incumbent technocrats to retire from their official positions in order to open private businesses. This transformation was allegedly related to their search for business fortunes. Keenly perceiving the impending end of the oil related development boom and tightening market conditions with the gradual stabilization of the business environment, a number of able technocrats left government

jobs to become private businessmen. A recent metamorphosis into entrepreneurs of competent, young, Western educated bureaucrats such as Yusif al Hamdan(ex-deputy commerce minister), Abdul Aziz Dukhayl( deputy finance minister), Ahmad Siraj( assistant deputy foreign minister), Fuad al-Farsi (deputy industry and electricity minister) reflects this trend (Shaw and Long 1982:78-80). In addition to these bureaucrat turned businessmen, relatives and close friends of incumbent technocrats constitute a significant portion of this category.

The popularity of ex-bureaucrats and their close associates among Korean firms derives from some unique qualities held by this group: close proximity to decision-makers, technical and procedural expertise, and a low profile in business operation. Regarding the importance of this category of businessmen, a veteran contract manager of a Korean firms has said:

In selecting agents, the most crucial criterion is the accessibility to contract information on the nature, timing, and clients of the projects. Political influence or visibility is a second criterion. Those who have a high accessibility are mainly former senior officials or close relatives and friends of incumbent bureaucrats And they know how to muddle through all sorts of redtape, and nitty and gritty demands without necessarily wielding political influence and thereby risking a high publicity. (interview, March 21 1983 with Mr. Y.Kim of the Samsung Construction's Jeddah Branch Office)

The price demanded by these businessmen in return for their services is even higher than for royal family members. As

table 5-6 indicates, they usually demand exclusive agencies with much higher commission rates.<sup>47</sup>

The number of royal family members and of big, traditional merchants involved in agent activities was relatively small.<sup>48</sup> While the latter represents 13.6% of the total (23), the former accounted for only 5.3% (9). This phenomenon might be partly attributed to the small size of the population falling into this category. In other words, there are not so many princes nor many big merchants as we commonly expect.

In the case of the princes, their involvement in business was more indirect than direct. The magnitude of their involvement varied from one group to another. One group of princes was omnipresent and comprehensively involved in various projects across ministerial boundaries. Prince Muhammad bin Fahd (fifth son of present King), prince Faisal bin Khalid (first son of late King Khalid), prince Wallid bin Talal (son of prince Talal, a famed leader of free prince movement in the early 1960s), and prince Ahmad bin Turki al-Sudairy belonged to this type. On the other hand, the second group has adopted lower profile and has pursued very specialized areas of interest. For example, prince Mansour was offering his agency chiefly for contracts emanating from the Yanbu Royal Commission where his full brother prince Naif reigns as the Governor. Prince Mishaal, who is full brother of prince Mutaib, Minister of Housing and Urban Development, used to confine his agent activities to his own business and sometimes to his

brother's ministry. Perhaps this range of business operation might be a function of their structural position within the royal circle.<sup>49</sup> According to the author's finding through field surveys, however, this is related rather to entrepreneurial capabilities of the prince or his associates. Thus, their business practices, viewed from agent type and commission rate (refer to table 5-7), indicate that they are not as ambitious as the ex-technocrat class.

For the large traditional merchants, meanwhile, Korean firms are normal business partners as are Western firms. However, even in this category, there are two different types of entrepreneurs. One represents truly traditional merchants whose business activities date back to the Hejaz, catering to the needs of the Hajji to Mecca. They include the Ali Reza family, the Sulayman family, the Ba Khashab family, and the Olayans, Kanoos, Jamzums, and Goshaibis (Shaw and Long 1982:78-80 ; Niblock 1980:92-93). Another group is composed of neuveau riches represented by Khashoggi, Pharaon, Ojjeh, and Kamil. Both have large financial resources and wide international business connections. Korean firms were able to co-opt most of them as agents.<sup>50</sup> These two groups show quite a different business style. While the former pursues more standard-business approaches widely utilizing their age-old family connections, the latter is more flamboyant.

Finally, our field survey revealed an interesting

phenomenon. That is the influence of local-tribal elites. A conventional understanding of Saudi politics argues that the influence and power of local elites have sharply eroded with the gradual, but systematic penetration of the central administration into local provinces (Lackner 1978; Abir 1983; Said 1979; Awaji 1972). This conclusion does not seem valid. As table 5-6 illustrates, a substantial number of Saudi agents for Korean firms come from local-tribal elites (12.7%). According to the author's survey, they exercise significant influence over the projects originating from provincial governments. At the same time, Jeddah or Riyadh based entrepreneurs tend to be less aggressive in relation to these projects. This may be due to the redistribution of oil wealth, which in turn enhances their allegiance and support to the House of Saud (Hukuma).<sup>51</sup>

The social and political distribution of the Saudi agents for Korean firms above discussed well elucidates how pervasive and penetrative the Korean firms' business connection with the Saudi counterparts. Here, however, an interesting question arises on how the technocrat and new middle class merchant could play such influential roles in promoting bilateral ties between Korea and Saudi Arabia. This puzzle can be easily explained when we examine the modus operandi of the Saudi Arabian political system as it relates to the private business sector.

The structure and process of the Saudi political system is best characterized by a patrimonialist political

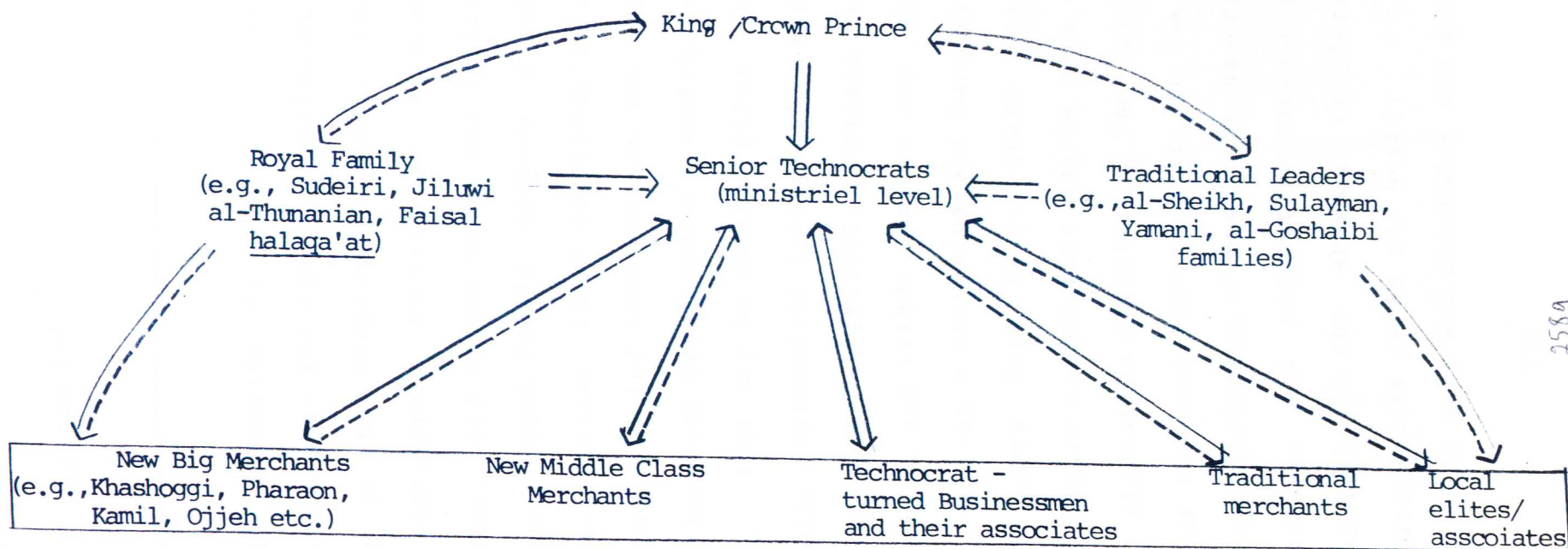
leadership firmly based on the logic of patron-client interactions. In a sharp contrast with Western countries, there are no such formalized institutions as interest groups, labor unions, and political parties in the Kingdom. Instead, Saudi Arabia remains a traditional tribal society in which informal groups, such as clans and kinship groups, are the key social and political realities. These informal groups are highly personalistic in character and take shape on the basis of constantly fluctuating ties and relations among individuals (Bill and Leiden 1979:75-77; Koury 1978 ). Thus in Saudi society, the personal tie is the basic channel and form of social and political organization. This personal tie is usually based on an hierarchical assemblage of halqa'at ( i.e., rings, branches, clans) which structures the unique pattern of patron-client relationship. the halqa'at arrangement takes a form of pyramid networking in which various informal societal groups are horizontally and vertically interwoven.<sup>52</sup>

Vertically the leaders of the halqa'at are convergent with their followers' opinions and demands, forming a mutual reward structure. Horizontally they negotiate and bargain with other halqa'at in exchange for allegiance and support. This political mechanism shapes a very unique form of political communication. That is, everyone is connected with figures on every step of the ladder of political power even without a formal open communication

mechanism which is prevalent in modern Western pluralist societies. Even a blind old bedouin can have access to the King or equally powerful figures either directly through regular grievance meetings, or through his halaqa'at network. This informal personalistic political structure, which Bill and Leiden call "tribal constellations" (1982:159), prevents the excessive accumulation of wealth and business opportunities in few (e.g., princes and big merchants) and allows chances for new middle merchants and technocrats, who become the major counter-parts of Korean firms.

It is this unique political structure that accounts for the scope and magnitude of the Saudi-Korean business connection. Diagram 5-1 is a rough presentation of the political structural position of the Saudi agents for Korean firms. The ultimate balancer and allocator of business opportunities in the Kingdom is the King and/or Crown Prince.<sup>53</sup> There are three major groups under the patrimonial leadership of the King and/or Crown Prince: i.e., royal family members, technocrats (senior), and traditional leaders comprising both tribal and religious leaders. All of these three groups are directly or indirectly inter-related to other four major sub-stratum business actors: traditional merchants, technocrat-turned businessmen, new middle class merchants, and local merchants or elites.

Diagram 5-1: Business-State Relationship in Saudi Arabia :  
A Schematic Presentation



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direct linkage  
 direct and/or indirect linkage

Agency  
 Sponsorship  
 Joint-venture  
 Unilateral venture in manufacturing, etc

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Diagram 5-1

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It is, however, misleading to postulate that this patron-client networks give the equal accessibility to all the business groups in the Kingdom. Indeed, there are inequalities and differences in terms of allocation of business opportunities. Our common sense may indicate that this being the case, royal family members should have the upperhand in monopolizing these opportunities. The author's field survey revealed that this is not the case. The key actors in allocating the Kingdom's wealth are senior technocrats. This may be natural given the fact that the Saudi senior technocrats (especially ministriel level) is a mixture of powerful princes, western educated elites, and traditional and tribal leaders and therefore that their decisions reflect a consensus and harmony of the Saudi community.<sup>54</sup> Apart from this, there are other reasons which place senior technocrats on the core of the Saudi's decision and allocation structure. They include: a high concentration of business opportunities in the public sector and the dominant authority of senior technocrats in initiating, implementing, and regulating various policies and projects ( especially in the absence of formalized check and balance institutions as in the West).

In other words, it is they who determine who gets what

except in unusual cases. Royal family members outside this immediate technocrat circle cannot exercise direct influence on the decision process. Nor can new big and/or traditional merchants. As in Diagram 5-1, thus, all the business actors in the Kingdom pursue their business interests in close direct or indirect interactions with senior technocrats. One caveat is in order, however. Political influence formed through personal ties and proximity is not the only determinant of who gets what. These senior technocrats combine the logic of rational choice (e.g, awarding tenders to the lowest bidders) with the prudent calculation of dynamics of halaqa'at politics. For this reason the Sudeiri clan and its associates, the most powerful halaqa'at in the Kingdom, cannot monopolize all the business opportunities as often conjectured by Western observers.<sup>56</sup> And contrary to frequent assertions, these technocrats do not constitute an island of princes, sheikhs, and western educated young turks isolated from the grass-roots. They continually interact with every member of business community directly or indirectly and attempt to come up with optimal allocations of the Kingdom's wealth carefully calculating the legitimacy of the House of the Saud, conflicting interests among various halaqa'at, bureaucratic efficiency, and sometimes personal interests and favors.

### Limits of Entrepreneurial Dynamism?

In all, Korean firms have penetrated virtually every aspect of the Saudi politics within a short period of time by forming a pervasive and in-depth business connection in the Kingdom. Along with price competitiveness, the formation of this business connection had greatly facilitated the Korean firms' successful entry and dramatic expansion throughout the 1970s. However, boom and expansion were not permanent despite the formation of these strong business ties. Having achieved its best year in 1981 with \$13.7 billion of new contracts, the Korean construction industry began to decline. Losing to local and other Third World entrants on the one hand (especially in labor-intensive projects) and to OECD countries on the other hand in high-tech field, Koreans are witnessing the danger of isolating their activities in the Saudi market. In other words, Koreans' entrepreneurial dynamism has not been able to cope with changing market conditions in the Kingdom. As market conditions change, the nature of a once strongly consolidated business connection began to change in such a manner that their complementary relationships fell apart as new tensions and conflicts of interest arose. In sum, given above discussion, our original hypothesis seems valid in a limited sense. Although the channel and process-level dynamics of bilateral ties can be conceived as being a

function of entrepreneurial dynamism, entrepreneurial dynamism and the formation of business connection alone do not fully account for the rise and decline of bilateral transactions between Korea and Saudi Arabia.

What accounted for these changes in market conditions and for the resulting constraints to entrepreneurial dynamism? Again, they were induced by government policies of both countries. Saudi Arabia began to pursue the Saudi-ization policies in order to protect local business interests, which not only restrict Korean firms business operations in the Kingdom, but also give a birth to a new brand of competitive local business actors under their protective umbrella. At the same time, negative signals started to come from the Korean government too. By pursuing an economic liberalization, the Korean government began to reduce its facilitative as well as coordinative interventions in the national economy in general and the overseas construction industry and export industry in particular. The results have been rising wage costs, limited financial and tax supports, and the formulation of various regulative policies.

As we shall discuss in Chapter Six, business interests in both countries could not contain the state apparatus within their grasp. Rather, they had to act within a set of parameters structured by the governments. This raises a number of questions crucial to our study: What is the nature of business-state relationship? What is responsible for this rise and fall of business interests? What is the

degree of compatibility between entrepreneurial dynamism and state policies? The following chapter attempts to elucidate this set of questions with specific regard to the entrepreneurial role of the state.

### Footnote

1. The nature and form of business connection is a function of political and economic organization of a given country. In a socialist setting, such a connection is not allowed. For example, Iraq and Libya in the Middle East strictly prohibit such entrepreneurial ties.
2. Due to the Confucian tradition, the ruling political ideology of the Yi Dynasty, which discriminates social status by occupational type in the order of gentry, farmer, engineer, and merchant, the merchant class could not flourish during the Yi Dynasty.
3. There were exceptions. Dusan and Samyang were two exemplary cases for national bourgeoisie. For this, refer to B. Park(1975), K. Kim(1976) and Jones and Sakong (1980).
4. Immediately after the coup in 1961, the military government arrested a number of leading businessmen by the Law on the Illicit Accumulation of Wealth. But within less than two years, president Park released them from various restrictions and utilized them for the initiation and operation of basic industries. For this topic, consult J. Kim(1964) and Y. Kim(1978).
5. Daewoo conglomerate is the case in point. The firm started as an offer agent in 1967 with the capital of \$10,000. Ten years after, the size of the capital astronomically increased to \$ 21 million with annual exports of \$320 million (B. Park 1977: 197).
6. The General Trading Company is an emulation of the Japanese Shogo Shosha system. Until 1977, there was no provision defining obligatory exports to the Middle East as a prerequisite for being qualified for the GTC. However, the 1977 revision of the law concerning the GTC inserted such a provision (KTA 1979; B. Bae 1977).
7. For a general overview of export promotion scheme in Korea, refer to Krueger (1978), Balassa (1981) and W. Hong (1978).
8. In the mid-1970s, the monetary value of export subsidy was a 20 cents for every one dollar worth of exports (Bae 1977:234).
9. In the case of Yulsan, the debt ratio was 1,062.8%, while its own asset was less than 10% of the total (M.

Park 1981: 154).

10. From an interview with G. N. Won, founder of the Won Enterprises (Jan. 28, 1983 at Seoul).
11. N. Sung is president of Korea Overseas Construction Corporation.
12. In the mid-1970s, export rank was very important since it determined the proximity of private businessmen to president Park and thereby various concessions from the government.
13. Of course, entry conditions expounded by industrial organization literature do not nicely fit in the Saudi Arabian market since there is a high level of market distortion.
14. For a discussion of Arab entrepreneurship, consult Farmer (1959: 73-86) and Saygh(1962).
15. Some observers argue that compared with Iranian and Kuwaiti merchants, Saudi merchants are quiet and less shrewed. However, the author finds Saudi merchants are as tough as Iranian and Kuwaitis in business bargaining.
16. Buyer's arbitrariness and random dishonoring of contracts were great obstacles to Korean firms. In many cases, customary international business practices were not honored, especially if counterpart is weak like Koreans.
17. Intermediary can be further classified as agent, sponsor(kafil) and partner. Sponsor usually refers to Saudis who provide employment to and legal protection for expatriate workers including the arrangement of entry visa and work permit, while partner involves joint-venture activities with foreign firms. In general, sponsorship and agency go together.
18. The tasks and duties of agent are chiefly a function of commission rate or vice versa. Depending on the level of compensation, some agents perform a simple role as finders, others may assume a more active role.
19. From interviews with various Saudi Arabian merchants and Korean contract managers in Jeddah, Saudi Arabia.
20. For this, refer to OCAK ( 1978), especially to remarks made by Sunkil Hong.
21. For the role of COE, refer to Whelan (1981: 32-35).
22. European firms did not enjoy the same of level of political and economic benefits as that of American firms. However, the strength of European firms came from the

Saudi's heavy reliance on European firms in consulting and project supervision.

23. When measured by amount, instead of the number of project, a share of principal contract is substantially high. In 1982, for example, principal contract accounted for 68%, while subcontract and joint-venture constituted 10% and 20% respectively. Thus, it can be argued that while subcontracting diminishes rapidly, principal contracting and joint-venture are increasing.

24. Interview with an employee of Hyundai who wishes to remain anonymous ( Jan. 28, 1982 in Jeddah).

25. Interview with E.S. Oh, a senior engineer as well as president of Oh Engineering Co.. ( Feb. 22, 1982 in Seoul).

26. In the early 1980s, however, labor costs began to increase rapidly, undermining Korean firms' competitiveness seriously. To cope with this obstacle, Korean firms began to hire cheaper workers from other Third World countries such as India, Phillipine, Thailand, and Bangladesh.

27. Interview with I.R. Cho, a former labor attache at Korean Embassy in Jeddah (Feb. 8, 1983 in Seoul).

28. Korean firms were willing to take low profit margins with the anticipation that they would be compensated in the domestic market with a vast array of discretionary or non-discretionary incentives such as real estate investment and corporate expansion.

29. The case of Won Enterprises was a good example for this.

30. For this topic, consult Jacoby, Nehemkis, and Eells (1977).

31. Here the notion of corruption could be very subjective. In the Winchian sense (or epistemological relativist ), corruption conceived by Western observers could be an accepted form of life or the legitimate norm for natives. Certainly, regarding the definition of corruption, there is a fundamental problem of inter-subjectivity between cultures. For this topic, refer to Winch ( 1972).

32. For vivid descriptions of political payment related scandals in the context of Saudi Arabia, consult U.S. Congress (1975: 180-186) and Lacey (1981: 464-471).

33. On a comprehensive discussion of the type of recipient, the mode of payment, and the objectives of payment, refer to Jacoby, Nehemkis, and Eells (1977).

34. According to the author's field survey, customary international commission rates are: 1%-2% for contracts

exceeding over \$100 million, 2%-3% for those between \$50 million and 100 million, 3%-4% for those between \$10 million and \$50 million, and 5% for contracts below \$10 million.

35. To detect any wrongdoings in the overpayments and other business practices, the Saudi government ordered all foreign firms to record book-keeping in Arabic.

36. Reportedly Hyundai's sponsor was prince Nawaf, prince-turned businessman from the Armenian clan of the House of the Saud. It is said that Hyundai did not pay the initially agreed full agent fee to him. Unpaid portion was reported to be about \$30 million, which in turn created all kinds of difficulty to the firm (Interview with Korean Embassy official who wishes to be anonymous, March 20, 1983 Jeddah).

37. As shown in Chapter Four, the Saudi government pursued various punitive actions against Western firms' price rigging practices from 1978. And the rural power projects which Hyundai tried to exercise influence over were the very controversial projects that triggered the Saudi government's anti-corruption drive. It was this overall mood prevailed in the Kingdom which gave a mismatch of timing for Hyundai.

38. Immediately after the scandal and imposition of ban on Hyundai's business operation in Saudi Arabia, the Korean government dispatched its foreign minister to settle the case in vain. One well placed Korean official hinted that even president Choi's state visit to the Kingdom in 1981 was motivated by the Hyundai's demand.

39. There are at least two salient reasons for Korean firms to actively pursue these non-conventional business practices. One was the cultural compatibility between Korea and Saudi Arabia on the issue of political payment. Both business cultures tend to view political payments as an accepted form of business behavior. The other was a perception widely shared by Korean businessmen that in absence of political backing from home government as that of Americans, the exercise of non-conventional practices is the legitimate instrument to compensate for such a deficiency.

40. Other major business interest groups in Korea are: Korean Federation of Industries, Korean Traders Association, Korean Chamber of Commerce, and Korean Federation of Small and Medium Industries.

41. This aspect will be discussed in Chapter Six in a full detail.

42. At present there are about 100 Korean firms doing business in Saudi Arabia. However, only 50 firms (initially 37 firms) are allowed to work as principal

- contractors, while others as subcontractors.
43. Drawbacks include: limited coverage of contracts, obligatory payments of agent fee for the contracts even if they are not obtained through those agents, and lack of expertise and incompetence to cope with changing market conditions.
44. Pharaon's father was one of the most trusted and close advisor to King Faisal. On Pharaon, refer to Lacey (1981) and MEED ( Special Issue on Saudi Arabia, June 1979).
45. These informations were obtained from interviews with present as well as former employees of these firms who wish to remain anonymous.
46. For the Saudi-ization, refer to Chapter Six.
47. There are usually three types of exclusive agency: one is based on functional specialities (e.g., exclusive agency for specific ministries). Second is a region specific (e.g., Hejaz, Nejd, and al-Hassa). And the last type is a sole comprehensive agency regardless of regions or functional specialities.
48. For this topic, consult Lacey (1981), Lackner (1978), and Koury (1978).
49. The House of Saud is a gigantic family composed of four to five thousand princes. Thus, it is quite misleading to assume that all the princes have equal access to power and wealth. Some have more, while others have less. In principle, their power and influence are determined by seniority and lineage.
50. Adnan Khashoggi, Pharaon, Ojjeh, and Kamil etc. were or are representing numerous Korean firms. However, Khashoggi is out of the business scene since he was banned from the Saudi market.
51. As modernization process continues, a sharp tension between the traditional system of allegiance between tribal leaders and the Houe of Saud (Hukma) and the newly emerging centralized administrative system (Dawla) began to emerge as a serious social and political problem. The continuity of power and influence of local tribal leadership as shown in the number of agents for Korean firms indicate another interesting dimension of the ruling Saud regime's shrew political skill in balancing two conflicting forces, i.e., Hukma and Dawla.
52. For an excellent discussion of this topic, refer to Koury (1978).
53. In principle, the King is the only and ultimate

allocator and balancer. However, as was seen in the case of relationship between late King Khalid and then Crown Prince Fahd, such a role can vary, depending upon the leadership style of the King.

54. For a social and tribal structure of technocrats in Saudi Arabia, refer to Rough (1973), Koury (1978) and Salomeh (1981).

55. By "unusual" cases is meant to those in which the King or Crown Prince directly intervenes, thus surpassing the authorities of each ministry or the Council of Ministers.

56. The Sudeiri clan is usually referred to as the "Sudeiri Seven" which is composed of King Fahd, Defense Minister prince Sultan, Interior Minister prince Naif, ex-Deputy Defense Minister prince Turki, Governor of Riyadh prince Salman, and Vice Interior Minister prince Ahmad. They are full brothers born between King Abdulaziz and bint Sudeiri.

## CHAPTER SIX

### STATE STRATEGIES AND THE EVOLVING NATURE OF THE SAUDI-KOREAN CONNECTION

In earlier chapters, we paid particular attention to the role of entrepreneurial dynamism and the consequent formation of a business connection which was largely responsible for the dramatic growth of bilateral economic transactions between Korea and Saudi Arabia. Although private entrepreneurs are crucial agents of these bilateral transactions, they are limited by the structural parameters set by state authorities. In other words, to a large extent, the success or failure of entrepreneurial dynamism in particular and the effectiveness of a business connection in general are a function of state strategies. This brings us to our third major hypothesis or assertion exposed in Chapter Two: "The outcome of inter-South bilateral flows is largely a function of the level of complementarity in entrepreneurial functions pursued by the states."

As discussed in Chapter Two, state entrepreneurship is broadly defined as the pattern of state behavior which is perceived to further maximize state interests as determined by the changing priority of its objectives. This behavioral pattern entails a set of incentives and/or

disincentives characterized by three major state functions; internal facilitative, external political management, and insulative functions. The facilitative function refers to the state's involvement in promoting and/or coordinating the private sector in order to achieve a set of goals, while external political management involves diplomacy, bargaining, and political concessions to enhance the state interests. The pursuit of these goals is accompanied by a set of internal and external constraints or negative outcomes which in turn trigger domestic political and social pressures. The insulative function is related to how the state treats these negative outcomes and the pressures emerging out of the deepening of bilateral interdependence between a pair of countries. The greater the state's ability to insulate the pursuit of bilateral economic transactions (or diversification) from various domestic pressures and demands, the higher and more enduring the level of bilateral ties between two countries. In this sense, the insulative function of the state constitutes one of key determinants of the direction and volume of bilateral economic flows.

With this basic theoretical orientation in mind, we shall test our third hypothesis by focusing on the three dimensions of the Saudi Arabian-Korean connection: 1) the nature and the evolving pattern of the strategies pursued by the Korea in relation to its bilateral ties with Saudi Arabia; 2) the strategic responses of Saudi Arabia and the changing nature of her external economic policy toward

Korea; 3) the overall outcome of bilateral economic transactions and the shifting pattern of diplomacy and bargaining between the two countries.

The Korean Strategy: Its Cyclical Pattern  
and State Entrepreneurship

Facilitative Functions: Once the Korean government chose Saudi Arabia as its strategic target for bilateral diversification in order to cope with deepening dyadic dependence on traditional trade partners and with systemic vulnerabilities, it deployed a set of wide-ranging policies to facilitate the Korean firms' penetration of the Saudi market. On the one hand, the government offered a variety of incentives to promote such penetration with enhanced competitiveness. On the other hand, it boosted Korean firms' entry and expansion in the Saudi market by carefully coordinating and regulating the behavior of the private sector, both business and labor, in such a manner that severe competition between Korean firms was avoided and wages kept optimal, yet calculated to enhance the international competitiveness of Korean firms.

Among the incentives provided by the Korean government, financial incentives were crucial to the promotion of Korean expansion in the Saudi market. As in any other countries' contract markets, Saudi Arabia followed<sup>1</sup> customary international rules in its tender activities. In

order to safeguard possible losses from intentional or unintentional blunders by bidders or contractors, and to force contractors to carry out the duties and tasks defined in the contracts, clients ( i.e., mostly the Saudi government) usually request contractors to come up with various bank guarantees for bid-bonds, performance bonds, advance payment bonds, and maintenance bonds. In general, bank guarantees for these bonds amount to about 20% of total bid value.<sup>2</sup> In connection with this requirement, Korean firms faced two major constraints: the size of bank guarantees needed and the procedural rules imposed by the Saudi government.

As briefly mentioned in Chapter Five, one of the salient characteristics of the Saudi contract market is the gigantic contract scale. Any project whose bid value is under \$ 50 million is usually regarded as 'small'. However, this was a mixed blessing for Korean firms. While such a scale offered large profits, commercial banks in Korea were reluctant to come up with payment guarantees. The Korean bankers' logic was clear: it was simply too risky. For example, if a Korean firm bid for and won a \$100 million tender, a bank would have to cover at least \$ 20 million payment guarantee. If the firm failed to perform the contract successfully,<sup>3</sup> the bank would be placed on the verge of bankruptcy. This risk factor, coupled with statutory limits on contingent liabilities, prevented Korean commercial banks from going ahead with payment guarantees for Korean contractors (H. Kim 1982:56-

58 ; OCAK 1982; 24-26). On the other hand, the Saudi government, especially the Saudi Arabian Monetary Agency (SAMA), enforced a strict payment guarantee rule on foreign contractors. In most cases, client countries request direct payment guarantees from an accredited bank of the bidder's country. However, the Saudi government was not only demanded a payment guarantee from a bank in the Kingdom, but also a counter-guarantee from a bank in the bidder's country. However, this counter-guarantee was valid only if the bank in the bidder's country was accredited by the SAMA. Otherwise, the bank would be obliged to get a double guarantee from those leading international banks accredited by the SAMA. This procedural complexity substantially limited the scope of Korean firms' activities in Saudi Arabia.<sup>4</sup>

Facing these constraints, the Korean government acted swiftly. First, to cope effectively with the gigantic contract scale and with the consequent payment guarantee, the government forced both national and commercial banks to reach an "Agreement on Payment Guarantees for the Construction and Service Business Activities in the Middle East" in May 1976. Second, on the basis of this agreement, the government formed a consortium composed of one national bank and five commercial banks.<sup>5</sup> Third, while the government loosened the statutory limit on banks' contingent liabilities by increasing it to 20 times, it also allowed banks to cover payment guarantees for Korean

firms operating in the Middle East contract market up to 600% of their capitals.<sup>6</sup> Fourth, to ease the difficulties stemming from counter-guarantee provision of the SAMA, the Korean government designated the Foreign Exchange Bank to open a syndicated credit line with leading international banks in April 1976. Simultaneously, the Korean government pursued active diplomatic efforts and obtained the Saudi government's approval in accrediting the Foreign Exchange Bank as a valid counter-guarantee bank, which in turn eliminated the complicated procedure of securing additional guarantees by the third party bank. Finally, as the nature of contract activities changed from prime or subcontract to joint-venture (refer to table 5-2), the Korean government expanded the scope of payment guarantees from the exclusive coverage of Korean resident firms to more flexible coverage of non-resident foreign firms joint-ventured with Korean firms. The magnitude of payment guarantees by Korean firms is illustrated in table 6-1. As of December 1982, \$5.4 billion was committed to the contracts coming from the Saudi market, which accounted for 70% of the Middle East total.

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Table 6-1

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Apart from bank guarantees, the Korean government

Table 6-1: Korean Banks' Payment Guarantees<sup>1)</sup>

(Unit: US \$ Million)

Performance Bond	Saudi Arabia	Middle East(cumulative)
Performance	1,737	2,359
Advance payment	2,361	3,494
Saudi local bank loans	1,192	1,531
Others <sup>2)</sup>	190	443
Total	5,480 (70%)	7,827 (100%)

1) As of December, 1982.

2) Maintenance bond and bid bond guarantees.

Source: Ministry of Constitution and Ministry of Finance.

provided Korean contractors with other financial incentives. For example, overseas construction firms enjoyed the same benefits in export financing as merchandise exporters.<sup>7</sup> In addition, in January 1976 the Korean government established a separate financial fund exclusively to support overseas construction with a government contribution of 20 billion Won and the Korean Export-Import Bank's contribution of 100 million Won (total US\$ 400 million). Second, relaxing strict provisions on foreign exchange law, the government allowed construction firms to solicit foreign currency loans from Saudi banks by placing stand-by letters of credit from Korean banks as collateral. This in turn greatly facilitated the Korean firms' financial maneuverability in the Kingdom.<sup>8</sup>

Third, the Korean government's support for firms operating in the Kingdom was dramatized by the designation of the Saudi riyal as a key foreign exchange clearance currency. This designation facilitated not only procedural matters in foreign exchange deals, but also substantially reduced foreign exchange risks involved in the use of the US dollar as the exclusive means of clearance. Finally, the Korean government set up a comprehensive administrative infrastructure to facilitate the financial transactions of overseas business operations. The Working Committee for Financial Support for Overseas Business Operation was established in 1976 to monitor finance related grievances from firms as well as to eliminate bureaucratic red-tapes. In addition, a financial attache was dispatched to Saudi

Arabia to coordinate, supervise, and train Korean firms in financial matters.

Korean firms operating in the Saudi contract market were provided with extensive preferential treatment in taxation as well. In order to promote these firms' competitiveness, the Korean government amended its tax law in Dec. 1975, and granted a 50% income tax and corporate tax exemption. In addition, a limited tax exemption for personal income earned by workers in overseas market was also granted. Other tax benefits covered the depreciation cost for equipment and machinery and the expenses incurred by overseas market exploration and feasibility studies ( Law on the Regulation of Tax Reduction, Articles 28, 126).

One of the most striking aspects of the tax policy was the recognition of losses incurred by non-conventional business practices. While US and Japanese firms suffered from strict regulations on political payments or non-essential expenditures by the Foreign Corruption Practice Acts, Korean firms, on the contrary, enjoyed tax benefits in this regard. For example, expenses incurred in the entertainment of foreign customers and in overseas market development (which include the controversial agent fees) were treated as business losses, thereby tax deductible (H. Kim 1982:97-99).

Although government supports were available, incentives in insurance were minimal, compared with OECD countries. While OECD countries covered a broad insurance package for

their firms ranging from political risk, inflation, and foreign exchange fluctuation to credit, the Korean government covered companies' potential losses from unexpected political risks and those of banks deriving from payment guarantees (refer to table 6-2). However, the latter policy lessened Korean commercial banks' reluctance to guarantee bank payments for Korean firms to a great extent.

Finally, the Korean government set up a Fund for the Promotion of Overseas Construction in collaboration with the OCAK. This Fund created collective goods for the entire overseas construction business community. The Fund was used to introduce advanced technologies and modern management techniques. It also covered budgets related to technical assistance to client countries and to private diplomacy and cooperation with them, including Saudi Arabia (Law on the Promotion of Overseas Construction, Articles 19, 20, and 21).

As we shall see below, the various facilitative functions exercised by the Korean government in terms of financial, tax, and insurance incentives were not unique. Some OECD countries, such as France, Italy, and the United Kingdom, provided much more extensive and comprehensive incentives for their own firms operating in the Middle East market (refer to table 6-2). What differentiates the Korean government from the OECD countries in terms of promotion of overseas business activities, however, is the former's ability to control, monitor, and coordinate

private firms in line with its overall state objectives. In other words, in order to enhance the overseas construction industry, the Korean government systematically intervened in the market and forcefully modified business behavior even on the micro-decision level. In this regard, a senior official at the Ministry of Construction explained the government position on overseas construction as follows : " Overseas construction is a co-ordinated export policy just as much as manufacturing. The industry is co-ordinated and geared to reflect national policy. Thus, the scope of overseas business activities should fall into the larger context of national industrial policy and objectives." ( Interview, S. Lee, Ministry of Construction , Jan 25, 1983, Seoul)

The nature and scope of state intervention in the overseas construction market is carefully defined in the Law on the Promotion of Overseas Construction (LPOC, hereafter), enacted in Dec. 1975, immediately following the onset of the Middle East boom and amended three times thereafter.<sup>10</sup> The LPOC defines its objectives as " the improvement of balance of payments and the development of the national economy by promoting overseas construction activities and by enforcing reasonable contract performances." (LPOC Article 1) On the basis of these general objectives, the LPOC specifies the controlling, monitoring, coordinating, and bailing-out functions of the state vis-a-vis the private sector.

The crux of the Law lay its provision for the government to control tightly all business behavior in the private sector. This control was guaranteed by the government's authority to issue contracting licenses (Article 10). Without this license, private firms could not engage in overseas business operations. Since bank guarantees, labor mobilization, and other incentives were contingent upon the government's granting of contracting licenses, the absence of this license meant a de facto ban on business activity. The granting of the license was a function of many considerations: market conditions of client countries, trustworthiness of clients, insertion of escalation clauses,<sup>11</sup> pre-qualifications, performance capabilities, financial structure, and labor management capability of firms (Article 12; H. Kim 1982: 39; OCAK 1982; Lee 1981). The rationale behind such strict enforcement is illustrated in Article 10 of the LPOC : 1) in order to prevent disorderly and irrational bidding practices by Korean firms; 2) to upgrade international competitiveness of Korean firms and thereby to enable firms to obtain more lucrative contracts; 3) to sharpen the overall image of the Korean government and firms.

Until 1980, any Korean contractor holding an overseas contract license was permitted to bid for any contract in Saudi Arabia. In Oct. 1980, however, the government amended the LPOC and classified overseas contractors into two classes, A and B (Article 17). Only class A firms were allowed to bid as prime contractors in the Saudi market,

while group B firms could bid as subcontractors. Of over 100 Korean firms doing business in the Saudi market, only 37 fell into class A. To qualify for class A, a company had to have completed overseas work valued at \$150 million and must have obtained at least \$50 million of work abroad in the first six months of 1980. In addition, a company had to have gone public by June 1981 or to have expressed its intention of doing so.<sup>12</sup> Those who failed to meet these requirements, but who held overseas licenses, fell automatically into class B. There was another stipulation that class A prime contractors had to subcontract a minimum of 10% and a maximum of 50% of their contracts to a class B Korean company (Reditt 1981: 5; MEED Nov. 20, 1981; H. Kim 1982; OCAK 1982).

This strict control of the private sector by the government was chiefly motivated by the prevalence and the intensification of price undercutting and competition among the Korean firms in the Saudi market. Until this system was revised in 1982, it consolidated government control and coordination over overseas contractors to the maximum, which in turn gave rise to domestic and external diplomatic opposition.

In accordance with Article 13 and 19 of the LPOC, Korean overseas contractors, without exception, had to submit their annual market plans to the Construction Ministry. In addition, all the contract or marketing activities which were related to bidding directly or

indirectly had to be reported to the Ministry ante facto. Thus, if a company planned to dispatch its marketing team abroad, the firm was obliged to report to the Construction Ministry seven days prior to the departure. If this option was not available, the team had to report to the respective Korean ambassadors in the client countries. On top of this, before finalizing an agency agreement with a local sponsor, a company was obligated to report to the Construction Ministry to seek counsel and an advisory opinion. Any company which failed to comply with these rules was banned from the bidding at hand and sometimes from the market itself.

13

This monitoring applied not only to overall forecasting and planning of the overseas construction industry by the Construction Ministry, but also was closely related to pre-emptive or preventive coordination efforts by the government. By detecting and monitoring business activities of firms, the government was able to prevent disorderly bidding practices or undue competition between Korean firms over the same projects by adjusting possible conflicts of interest in advance. The ultimate authority on this coordination and the decision over which company got what project resided in the Construction Ministry.

14

Another important interventionist policy of the Korean government was the introduction of a "bail out" system (Article 30). This system had two salient dimensions: one was to provide a financial rescue package to those firms on the verge of bankruptcy. As the US government rescued

Chrysler, the Korean government salvages Korean firms for the similar reason. The critical difference comes from the second dimension, i.e. the government's designation of certain firms to replace the firms already bankrupt in order to finish those projects left incomplete by the bankrupt firms. For the 1979-1980 period, five Korean firms operating in the Saudi market went bankrupt due to liquidity problems. Some 16 projects undertaken by these firms were left incompleated, triggering serious grievances and protests from the Saudi clients. The Korean government's response was to contact a number of successful Korean firms and ask them to take over those projects. For this purpose, the government provided a variety of incentives such as special concessional financing to ease liquidity problems related to these projects. In addition, those firms were given priority over the contracting licensing as well as over projects which were in competition with other Korean firms (B. Lee 1981: 9-15; H. Kim 1982).

In all, the control, monitoring, coordinating, and bail-out functions of the Korean government increased the Korean firms' competitiveness in the Saudi market. However, the coordinative role of the Korean government was not limited to the construction field. Labor was also carefully controlled and monitored, which in turn enhanced Korean firms comparative advantage over other competing foreign firms. In terms of a state-labor relationship,

Korea maintains an extreme form of corporatist labor control. Major labor organizations have traditionally been organized, controlled, and subsidized by the government. In addition, labor's rights to collective action and bargaining have been substantially limited. This general labor climate in Korea helped Korean firms manage labor problems relatively easily: first, labor unions were not allowed to form in overseas work sites; second, any agitators for labor disputes were immediately picked up by the Korean government officials and sent back to Korea ( B. Lee 1981; Korean Embassy 1981); third, potential agitators were usually eliminated by the initial screening process before mobilization.

The Korean government was supportive of overseas contractors in a number of other ways. For example, the Office of Labor Affairs operated an effective labor pool system by which workers in need were easily identified and rapidly mobilized. Further in order to prevent any potential labor disputes over wage differentials among Korean firms, the government introduced a standard term of employment applicable to all Korean firms . The government also dispatched labor attaches to Saudi Arabia not only to monitor but also to mediate labor disputes on the spot. Finally, the government limited the employment of Korean labor by foreign firms in order to prevent massive outflows of Korean workers to better paying Western or local Saudi firms. The government allowed such employment only when it did not conflict with Korean firms'

competitiveness.

Facilitative Functions in a Comparative Perspective:

The facilitative functions exercised by the Korean government have been extensive and varied. The interventionist policy paid off in terms of market expansion in the Saudi market, outpacing the once dominant Western firms. Regarding this state-business relationship, an American executive commented to the author:

We are not competing with Korean private companies. Our competitor is the Korean government itself. Korea Inc. manifested in overseas construction is far better coordinated and penetrative than Japan Inc.. Under the government umbrella, Korean firms are doing really well in the Saudi market. In no way, can we compete with them. (interview with Jensen, Jeddah, March 21, 1983)

Just how extensive and effective were the facilitative roles played by the Korean government, when compared with Western firms? Table 6-2 illustrates a comparison of facilitative policies between Korea and six major OECD countries in the overseas construction industry. As table 6-2 shows, Korea has not done as much as other nations in terms of the provision of incentives. Surprisingly, the French, the British, and the Italian government have been more active in offering various incentives to promote overseas contracting business. They cover a wider range of insurance, provide more extensive financial incentives even

including cash subsidies and bonuses, and extend the same level of tax benefits as the Koreans. Only Japanese and US firms lacked substantial support from their governments. In particular, they suffered from the enforcement of anti-corruption and anti-boycott legislation.

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table 6-2

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The Korean strength stems from the government's capability to intervene in the market and to control the behavior of its private sector. As shown in table 6-2, only Korea demonstrates a high level of coordinative attitudes, significantly above West Germany, Italy, and France. Again Japan (unexpectedly) and the US, along with the United Kingdom, reveal a lower capacity to coordinate their private sector. Thus Korean government's ability to control, monitor, and coordinate business and labor appears to compensate for a relative weakness in the provision of incentives.

External Political Management: While the facilitative functions discussed above are mainly concerned with the formation of internal supportive and coordinative systems,

Table 6-2: Incentives and Disincentives for Oversea Construction Industry : Country Comparison

	Korea	France	West Germany	Italy	Japan	U.K	US
Promotive poli- tics(Incentive)	M	H	M	H	L	H	L
<u>Tax Benifits</u>							
1) personal income tax	Y(L)	N	N	N	N	N	Y
2) corporate income tax	Y(L)	Y(L)	Y(L)	N	N	Y(L)	Y
3) value added tax on mate- rials, equip- ment and service	Y	Y	Y	Y	N	Y	N
<u>Financial Supports</u>							
1) cash sub- sidies, bonuses, tax credits for foreign projects	N	Y	N	Y	Y	N	N
2) grants and loans for feasibility studies	Y(L)	Y	N	Y	Y	Y	Y(L)
3) bid and performance bonds and guarantees	Y	Y	N	Y	Y	Y	Y
<u>Administrative- organizational support</u>							
1) anti-boycott act	N	N	N	N	Y	N	Y
2) corrupt practice act	N	N	N	N	Y	N	Y
3) promotion of							

3) promotion of nationalised or quasi-governmental construction firm	Y	Y	Y	Y	N	N	N
4) encouragement of consortia for foreign project	Y	Y <sup>3)</sup>	N	Y <sup>4)</sup>	Y	Y	N

Insurance Supports

1) political risk Y <sup>1)</sup>		Y	Y	Y	Y	Y	Y
2) inflation	N	N	N	Y	N	Y	N
3) foreign exchange fluctuation	N	Y	Y	Y	Y	Y	Y
4) credit	N	Y	Y	Y	N	Y	Y

Coordinative Policies	H <sup>2)</sup>	M	M	M	L	L	L
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discretionary licensing	Y	N	N	N	N	N	N
state intervention of contract activities	H	M	M	M	L	L	L
state "bailing-out" of bankrupt firms	H	M	M	L	L	L	L
labor management	H	L	L	L	L	L	L

- 1) Y: yes, N: no.
- 2) H: high, M: medium, L: low.
- 3) Part owner of Framatome, a construction corporation.
- 4) ENTE, quasi-governmental construction corporation.
- 5) (L): limited support.

Source: Re-adopted from "U.S. 'Arrogance' Costs Firms Billions in Lost Jobs", ENR, November 29, 1979(P. 28), and various documents and media sources.

external political management involves a set of foreign policy efforts to facilitate private sector penetration by winning the target country's political favors. In this regard, Korean political management vis-a-vis Saudi Arabia comprises three distinctive diplomatic efforts: political support of Saudi foreign policy, the formation of political linkages in Saudi Arabia, and cooperative concessions through technical assistance.

Korea's initial diplomatic support for Saudi foreign policy came during the October 1973 War. When the Arab oil producers announced cutbacks in production and exports of petroleum, the Korean government for the first time set forth a policy line overtly sympathetic to the Saudi position. The new posture of the Korean government emphasized four points: 1) the Arab-Israeli conflict must be resolved on peaceful and equitable terms; 2) conflict settlement must involve the withdrawal of Israel from the Arab territories the Jewish state occupied during the June 1967 war; 3) the national rights of the Palestinian people must be recognized in any Arab-Israeli settlement; 4) the sovereignty, independence, existence, and territorial integrity of all the countries of the Middle East must be recognized and preserved (Dong Ah Il Bo 12/3/1973). These four points were very close to the American position as well as the reflection of UN Resolution 242. However, the Korean government's recognition of Palestinian national rights was a sharp departure from the American position,

which had consistently influenced the Korean posture on the Arab-Israeli conflict.

This pro-Arab position was further strengthened by the removal of the Israeli Embassy in Korea to Tokyo, which is believed to be the result of the Saudi government's persistent pressure. Along with this policy shift, the Korean government took a more positive attitude toward the PLO to satisfy the foreign policy objectives of Saudi Arabia. In August 1979, the Korean Ministry of Foreign Affairs instructed its Middle East posts to activate their ties with representatives of the PLO. At the same time, the Korean government donated \$ 2 million for scholarships to Palestinian students through the United Nations Relief and Work Agency (UNRWA). Just one month before the scheduled visit of then President Choi to Saudi Arabia, a Saudi local newspaper reported that Korean recognition of the PLO was only a matter of time, quoting the Korean Foreign Minister's statement (Saudi Gazette April 9, 1980). This pro-Arab posture was well reflected in a joint-communiqué between King Khalid and President Choi on the occasion of the latter's visit to the Kingdom in May 1980, which stated: "The sovereignty and self-determination of the Palestinian people should be guaranteed, and the PLO is the only legitimate representative of Palestine." (Hankook Ilbo May 17, 1980).

Apart from taking positive steps toward the pro-Arab position, Korea has followed a foreign policy consonant with the Saudi position in the Iran-Iraq war. Traditionally,

Korea maintained a close relationship with Iran under the Shah. But as the Iran-Iraq dispute developed, Korea shifted its support to Iraq. There were a number of reasons behind this policy shift. First, Iran's new leadership under Khomeini was reluctant to acknowledge any cooperation with South Korea, not only because of the latter's strong linkage with Shah and his associates, but also because of North Korea's diplomatic offensive. Second, both Korean policy-makers and the private sector felt that a close tie with Iraq would be ultimately more rewarding. For policy-makers, such a tie meant diplomatic normalization between the two countries and a potential gain in the non-alignment movement as well as in the progressive forces of the Arab world. In addition the Iraqi market, then fueled by massive development programs, constituted a more lucrative market than Iran for the private sector. Third, the severance of diplomatic ties between Iraq and North Korea created a critical momentum for the Korean penetration in Iraq. Despite these incentives and disincentives, however, Korea's initial position was to maintain an equidistant posture between the two rivals. This neutrality did not last long because of the pressure of Saudi Arabia and the Gulf sheikhdoms. Saudi Arabia in particular pressured Korea to take a more explicit pro-Iraqi stance and a more pro-Arab position in the Gulf war. Korea complied for the fear of losing the Saudi market. This policy shift at the expense of Iran paid off.

Apart from the issues involved in the Arab-Israeli and Iran-Iraq conflicts, Korea has pursued cautious and prudent foreign policies in the Middle East. The basic premise was that Korean policies should not present obstacles to the foreign policy objectives of Saudi Arabia. This orientation led Korea to support the Fahd Plan in the international fora, to pursue policies sympathetic to conservative Arab monarchies, and to denounce Soviet aggression in Afghanistan and elsewhere in the region.

While making pro-Saudi diplomatic gestures with one hand, the Korean government actively sought with the other to create a broad base of political support for Koreans in the Kingdom. Attempts to form political linkages in Saudi Arabia were made through the two major channels, relying on conventional diplomacy to the maximum, and by mobilizing and utilizing the domestic private sector (Islam) as a means of promoting political linkages with a broad spectrum of the Saudi people. Conventional diplomacy comprised three distinctive approaches such as strengthening the diplomatic machinery in the Kingdom, intensifying personal diplomacy, and inviting influential Saudis to Korea. Before 1973, there was no residential Korean diplomatic post in the Kingdom. However, in less than five years, the Korean embassy in the Kingdom became the third largest diplomatic post with almost 100 members, similar to the Korean embassies in Tokyo and Washington. In addition, the ambassadorial post in Jeddah was given such importance that only cabinet-member level senior

officials were considered.

Another approach was the intensification of personal diplomacy. As we have discussed in Chapter Three, during the 1962-1973 period, only six Korean delegations visited the Kingdom. During 1974-1982, however, more than twenty delegations led by cabinet members and equivalent parliamentary leaders visited the Kingdom. Three prime ministers visited the Kingdom during this period. The climax of this personal diplomacy was marked by the state visit of president Kyu Ha Choi in May 1980. The Korean decision to pursue personal diplomacy of this nature can be attributed to three major motives:

1) The first was related to the pattern of Arab diplomacy itself which relies heavily on personalism. Aware of this, the Korean government dispatched high ranking officials to the Kingdom and personally assured Saudi officials of the Korean government's commitments and support to Korean firms operating in Saudi Arabia. This personalistic diplomatic style sharpened the Korean image in the Kingdom (i.e., close cooperation between state and business) and brought about a positive psychological effect for both Korean firms and their Saudi counterparts. In this regard, president Choi's state visit to the Kingdom in May 1980 illustrated the special point. In late 1979 and early 1980, Korea underwent a traumatic political shake up. President Park was assassinated in October and a military coup ensued in December 1979. Political

instability in Korea in turn provoked rumours and speculation over the uncertain future of Korean firms operating in the Kingdom. Both the Saudi government and the private sector soon became pessimistic on the situation of Korean politics, and were reluctant to continue cooperating with Korean firms. At this juncture, top policy-makers in Korea felt it necessary to promote president Choi's state visit to the Kingdom to assure personally of their unchanged position toward Saudi Arabia and those Korean firms doing business there.

2) The second motive was to create more intimate political linkages with senior Saudi officials. Korean officials sought to establish inter-ministerial cooperative schemes between the two countries. Ministries of Construction, Health, and Interior, for example, could reach bilateral agreements on mutual cooperation, by passing Foreign Ministry channels.

3) A further rationale behind the pursuit of personal diplomacy was related to the role of the "trouble-shooter". As the Korean involvement in the Kingdom deepened, it was accompanied by a number of accidents, and problems including labor disputes, illegal immigration, violation of the Saudi laws, defaults of contract obligations by Korean firms etc.. For those case which Korean diplomats could not handle through normal diplomatic channels, the Korean government dispatched cabinet-level senior officials as "trouble shooters". When the Jubail labor riot took place in 1977, the Korean prime minister was sent to apologize

and to assure the Saudi government of tighter labor management in the future. One source claims that the Saudi government was so impressed by the sincerity of the Korean government shown by prime minister's visit that it dropped its plan to restrict Korean operations in Saudi Arabia. <sup>21</sup>

As we discussed in Chapter Five, when the Hyundai bribery scandal became public, the Korean government sent the Foreign Minister in vain to settle the case politically. When the bankruptcy of Kong Young Construction, one of the largest Korean contractors in the Saudi market, caused a panic among Korean firms about possible spill-over effects, both the Finance and Construction Ministers flew to the Kingdom and solicited cooperation from the Saudi officials by assuring the Saudi government that the Korean government itself would guarantee the fulfillment of the firm's pending obligations. <sup>22</sup>

The third approach was to invite influential Saudi officials, businessmen, journalists, and other dignitaries to Korea in collaboration with Korean companies. In this approach, two tactics were widely used. One was to invite senior officials of the Saudi government agencies from which major tenders would emerge. Particularly, given the fact that Saudi officials' perception and/or assessment of Korean industrial capability was initially either indifferent or very low due to ignorance, such a tactic was very effective. Another method was to cooperate with

private firms in selecting and entertaining prospective invitees. The Korean government requested private firms to submit a list of influential business partners or associated government officials who deserved official invitation from the Korean government. Once they were invited, they were treated as government's official VIPs. This tactic was most rewarding. For the government, such an invitation was a chance to consolidate pro-Korean influence in the Kingdom, while for private firms, it was a valuable opportunity to demonstrate their strong ties with the government to Saudi partners.

The Korean government's efforts to form political links with the Kingdom were not limited to official circles. It also fully utilized the domestic private sector to achieve its objectives in Saudi Arabia through was Islam. Islam in Korea has a short history (introduced in 1955 by the Turkish troop stationed in Korea). Its Muslim community is meager--- a population of 3,000 to 5,000 in the mid-1970s. Its short history and small size had prevented the Korean government from realizing its political and cultural importance in the earlier stage. But the vitality of Islam as an effective means of making important international contacts surfaced in a series of happenings prior to the blossoming of the diplomatic relationship with the Kingdom. In 1970, the late King Faisal visited Japan. Muslim leaders in Korea managed to get an audience with him. In the following year (1971), Sheikh Hassan Kutbi, then Minister of Haji and Endowment, visited Korea to assess the

situation of the Islamic community in Korea. Through these two events, the existence of an Islamic community in Korea was made known to Saudi religious leaders. A major role was played in 1973 by Korean Muslim delegates who visited the Kingdom to attend the annual meeting of the World Muslim League. During their visit, the delegates had another chance to meet King Faisal. In this meeting, Korean delegates appealed to the King to write a personal letter urging president Park to support Islam in Korea. The King willingly accepted their request and wrote his personal letter breaking diplomatic protocol. The Korean response was prompt. The late president Park dispatched his personal envoy to the Kingdom with his reply in hand which in turn opened a new horizon of diplomatic relationships between the two countries.

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The political value of Islam was more strongly felt by Korean policy makers as the Korean involvement in the Kingdom became more extensive. One Korean senior diplomat posted at Jeddah described Islam's essential value in the following:

We are totally dependent on Saudi Arabia. We import 60% of our oil from the Kingdom and earn billions of dollars from the Saudi market. But we have nothing to give them back in return. We do not have any political, military and cultural resources to use as bargaining leverages or concessions. In this context, Islam can be regarded as the only means to widen our channel of communications with the Saudi people. But our dilemma is that support for preferential treatment of the Islamic community in Korea violates our

constitutional provisions on the separation of state and church. (interview March 18, 1983 Jeddah)

For all this constitutional constraint, however, the Korean government was supportive of Islam in a number of ways. The government donated a land site for the construction of the first Mosque in Seoul. At the same time, it contributed a land site valued at \$ 3 million for the construction of an Islamic College sponsored by the Saudi government. Korean embassy in Jeddah facilitated the propagation of Islam among Korean workers in the Kingdom indirectly. The Korean government even solicited the establishment of a World Muslim League (Rabita)'s liason office in Seoul.

By portraying this pro-Islamic image, the Korean government was able to draw support from the Saudi people. The utilization of the Islamic connection led to a formation of pro-Korean forces, though limited, from non-business areas such as religious and traditional leaders. The Korean Islamic community was also instrumental in soliciting Saudi support in some major issue areas such as oil concessions during the second oil shock.

Another aspect of external political management adopted by the Korean government was to extend various concessions to the Saudi government in terms of technical assistance. As discussed in Chapter Four, in order to win political support, the Korean government actively pursued the technical assistance option. This posture was congruent

with the Saudi's efforts to diversify its sources of technology and to upgrade its manpower. During 1974-1982, 60 agricultural technicians, hundreds of nurses and medical doctors, and railroad system engineers were dispatched to the Kingdom. A number of Korean economists and scientists were sent to the Ministry of Planning and the Saudi Arabian Center for Science and Technology (SANCST) and participated in the process of long term development plans. At the same time, the government, in collaboration with the private sector, invited engineering students and petroleum technicians for technical training in Korea on a regular basis.

In sum, political management efforts by the Korean government were as comprehensive and intensive as its facilitative schemes. Although there were substantial limits to the effectiveness or outcomes of such efforts, they were instrumental in reducing various political barriers imposed on private companies, and in boosting the psychological morale of both Korean firms and Korean workers. What distinguished Korean political efforts from other, particularly OECD countries, and what makes them interesting is their unique style of using diplomacy and foreign policy. Three major characteristics can be delineated in this regard. 1) There was no clear-cut dichotomy between the private and public realm in determining a set of foreign policy and diplomatic responses. The demarcation between the two was blurred and the state led and orchestrated the private sector within

the framework of state interests or objectives situationally defined. Indeed, both public and private interests converged. 2) A high level of the government sensitivity and willingness to promote private interests impelled Korean officials to act like salesmen and commercial arbitrators. 3) While other countries had to deal with domestic pressure and interest groups in shifting their foreign policy postures, Korea did not face such obstacles. Whatever the executive branch decided was implemented without any domestic resistance.

Insulative Functions: The pursuit of facilitative policies and external political management discussed above cannot operate in isolation from other social and political consensus. As is the case with most policy-making processes, the Korean government's preferential treatment of exporters and overseas contractors involved political opposition and grievances from other segments of the society. Thus, the consistency and effectiveness of such supportive policies are chiefly a function of the state's ability to "depoliticize" or "insulate" them from competing political claims and opposition. In this sense, insulative functions and related capabilities of the state become the key variable in tracing and predicting possible policy changes vis-a-vis the industrial sectors concerned.

The striking aspect of Korean entrepreneurship viewed from the state's insulative role is a high degree of

variability and maneuverability. When the nature and direction of the overseas industry and export sector matched a set of state objectives (such as balance of payments improvement and growth), the Korean government actively attempted to insulate them from other sectors' claims and demands and to provide a comprehensive range of incentives and supports. On the other hand, when these overseas sectors began to produce negative impacts and became political liabilities, the government swiftly turned its back on them and lifted the insulative shields. The period 1974-1979 reflected the congruity of mutual interests between the state and overseas contractors. The government badly needed foreign exchange to improve its balance of payments position as well as to fuel rapid growth, and the overseas construction industry satisfied such needs. This complementarity of interests between the state and the industry induced the government to support actively the export industry and to protect it from opposition. The great portion of facilitative and political supports previously discussed were initiated and implemented during this period. In the post-1979 period (especially since 1982), however, as the overseas industry began to change from a political asset to a liability with falling profits, extensive competition, and excessive reliance on banks, the government gradually began to reduce its support. In what follows, we shall examine this changing nature of these insulative functions by focusing on two separate cases.

Case One: An Antinomy of Wealth?: the Case of  
Foreign Exchange Regulation

As discussed in Chapter Four, balance of payments deficits have been endemic to the Korean economy throughout its modern economic history. Thus, the government's enthusiastic support for the overseas construction industry was quite logical. But a serious problem arose when a delicate trade-off relationship appeared between the two competing state objectives: inflation and balance of payments. Owing to the government's strong construction export drive policy, the overseas construction sector was able to generate a tremendous amount of foreign earning, contributing to the first balance of payment surplus in Korean economic history in 1977. Foreign reserves in 1976 were \$2.9 billion, but this was more than doubled by 1978 to over \$ 6 billion. An improvement in foreign payments caused another dilemma, however. This was the explosive monetary expansion and leading to serious inflationary pressures. The massive inflow of foreign exchange from the overseas contractors further aggravated the then already overheated economy through overinvestment in the heavy industrial sector.

The government immediately took steps to alleviate the situation. The most striking measure was the enforcement of an obligatory deposit of foreign exchange earnings in

banks for a certain period of time. During this deposit period, overseas contractors were not allowed to utilize their earnings. By that measure, in the mid-1978, the government was able to freeze more than \$100 million. The overseas construction industry panicked. Many of them went to the verge of bankruptcy. One top executive described the situation at the time in the following way:

Our firm has about \$10 million in bank. But we can not use that money at our disposal because of the government's foreign exchange freeze. We have to borrow high-interested money from elsewhere to meet our financial needs.-----Because of this measure our firm is about to go bankrupt in spite of surpluses and success. ( J.I. Lee of Dae Lim Corp. OCAK 1978: 108)

The OCAK fiercely lobbied for the alleviation of this measure, but in vain. The Ministry of Construction also strongly argued for lifting these restrictions. But the Economic Planning Board and Ministry of Finance, the primary agencies in charge, were unshakable. They counter-argued that the freeze was inevitable not only for effective monetary management in connection with massive inflow of foreign earnings, but also necessary to prevent the overheating of the national economy caused by overseas contractors' "unhealthy" utilization of such earnings as real estate investments, flooding the curb money market to take advantage of the huge disparity between domestic and international interest rates ( domestic interest rates were almost two times higher than international rates), and

reckless corporate acquisitions. In early 1980, the measure was eased by the introduction of a comprehensive foreign exchange management system.<sup>35</sup> But this policy change was not the result of political efforts by overseas contractors, changing economic conditions. A worsened balance of payments position, coupled with the onset of severe recession since 1980 obviated the need for such measures. Indeed, the fate of overseas construction industry was at the mercy of the government.

Case Two: Falling Profits, Liability and Changes  
in State Policies

Until 1978, Korean firms enjoyed high profits in the Saudi market. Starting in 1979, however, these profits declined. As table 6-3 illustrates, the ratio between the total amount received and spent fell from 105.8% in 1978 to a surprising 80.5% in 1979. This trend continued although recovered a bit in 1982. Since table 6-3 does not include the values of materials and equipment already purchased and the amount of receivables, it does not reflect profit levels in the true sense. However, it does reveal the fact that profit margins have declined substantially since 1979.<sup>36</sup> There were a number of factors responsible for falling profits of Korean firms in the Saudi market: rising labor costs, declining competitiveness against local and Third World firms,

increased costs of capital ( both domestic and international interest rates), sophisticated price sensitivity of the Saudi government, and price dumping by Korean firms to cope with immediate and pending liquidity problems. Furthermore, a sharp reduction of advance payments from an average 20% to 10% and the delays in the pro-rata payments, which were taken by the Saudi government in lieu of falling oil revenues from 1982 on, affected business performances of Korean firms to a great extent.

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table 6-3

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If this phenomenon had taken place prior to 1978, Korean firms might have been able to manage. Galloping inflation, earnings from real estate investments, and other speculations taking advantage of disparity between domestic-international interest rates could have been sufficed to compensate for their losses abroad. But the government's tight anti-inflationary and foreign exchange control measures eliminated such loopholes. Under the circumstances, Korean firms could not but help rely on domestic banks. In 1980, the OCAK, representing such interests, made numerous petitions, proposals, and

Table 6-3: Financial Balance Sheet for the Saudi Contracts

(Unit: US \$ Million)

	1973-76	1977	1978	1979	1980	1981	1982 <sup>1)</sup>
Amount received(A) <sup>2)</sup>	604	1,334	3,020	3,280	4,150	6,126	5,798
Amount spent(B)	518	1,295	2,855	4,073	4,831	6,745	6,230
Balance ratio(A/B)	114.0	103.0	105.8	80.5	85.9	90.8	93.1

1) By November 1982

2) Values of equipments and materials already purchased, and the amount of receivables(unpaid) are not included in these figures.

Source: Ministry of Finance, 1983.

recommendations to alleviate worsening business conditions. The crux of their demands was straightforward: leniency in credit policy and bank guarantee policy. The Association requested more flexible and preferential bank loans to its member companies and the increase of payment guarantee from the current (1979) limit of 600% of banks' capital to 1000-1500% (Maeil Gyeongje Sinmun Feb. 16, 1980).

The banking community was outraged by this demand. In fact, by then, the Ministry of Finance and the Bank of Korea (central bank) were drafting substantial revisions in the bank law in such a way that commercial banks' payment guarantees would not exceed more than 50% of their capital with a partial exception which would allow up to 100%. Intense bureaucratic skirmishes ensued between the Ministries of Construction and Finance. With the intervention of National Assembly, a compromise was reached: strict screening of payment guarantees, rejection of bank guarantees for those firms which practiced price dumping, and payment guarantees up to 500% of banks' capital (Maeil Gyeongje Sinmun Sept. 25, 1981 and interviews). A senior official at the Bank of Korea expressed his feelings on the issue in the following manner:

How can banks give more loans and payments guarantees to the companies whose business performances are falling apart. There must be limits to financial rescue and in bailing out firms in trouble. Both the government and banks cannot be dragged into losing game. Indeed, the market principle called 'the survival for the fittest' should be the rule. That is the only way to get out of our present dilemma. (interview, Seoul, Feb. 18 1983, with D.K. Lee, Deputy Superintendent of the Bank of Korea as well as former financial attache to Korean Embassy in Saudi Arabia)

Meanwhile, five major contractors went bankrupt and a growing number of firms faced grave liquidity problems. However, measures were not taken until a notorious financial scandal broke out in 1982. It was the Young-ja Chang scandal related to the curb money market, which almost paralyzed the Korean financial and banking system. The scandal soon escalated to a political scene since the major actor turned out to be a close relative of President Chun and former CIA Deputy Director. In this scandal, Kong Young Construction, one of Korea's top 15 contractors in 1981, was deeply implicated. The company voluntarily put itself under court supervision and trading of its shares on the stock exchange was suspended.

As the scandal seriously undermined the legitimacy of President Chun, the government took drastic measures to expedite banking and financial liberalization which allowed banks more autonomy. Within this scheme, the government's preferential credit policy toward the overseas construction sector began to diminish. In fact, the

Ministry of Finance pledged that it would not intervene in bank decisions on payment guarantees and loans for overseas contractors. In line with this policy shift, the relative weight of the Working Committee for Financial Supports for Overseas Business, which oversaw all banking and financial matters for these firms, was downgraded.<sup>39</sup> In sharp contrast with the first case, the second case illustrates how the market replaced the state intervention as a means of controlling the private sector. Furthermore, the second case exposes how the protection of political legitimacy by the ruling regime can damage its insulative role for private interests.

The two episodes illustrated above reveal the highly variable nature of the Korean government's entrepreneurship in relation to the private sector. In fact, there have been numerous cases which expose such state behavior. When labor disputes became frequent and intensified in the Saudi work camps since 1978 due to low wages, bad working conditions, and other welfare issues, the government co-opted them even at the expense of the firms by satisfying their demands.<sup>40</sup> When the government badly needed foreign earnings, it provided all kinds of incentives and domestic support to exporters as a way of promoting exports. However, when such the export drive triggered domestic supply bottlenecks and aggravated inflationary pressures, the government unilaterally imposed embargoes and export limitations on those items in short supply.<sup>41</sup> Even the overseas contracting licensing and careful coordination of

competition among Korean firms, the key aspect of Korean success in the Saudi market, did not last much longer. When the Saudi government strongly protested and criticized such an interventionist policy, the Korean government scrapped it and liberalized overall construction administrative policies, conceding its power and authority to the private sector in 1982.<sup>42</sup>

Implicit in above discussions is that the insulative function of the Korean government vis-a-vis the overseas construction industry has not been consistent over time. Rather it showed a cyclical pattern in which political calculus of the government was the key determinant of its shaping. In other words, when there was a congruity of interest between the government and the private sector, the former exercised its considerable insulative functions in such a way as to maximize private interests. However, as business performance of the private sector became liabilities to the state objectives (e.g. legitimacy, growth, economic stability, balance of payments etc.), the government changed its policy. The private sector did not have the power and resources to wield political influence to modify such state behavior. Its unique political link at the time of crisis was in one or two executive branches, parts of the state machinery, and thereby it was unable to resist state decisions made in a larger framework of state goals and objectives. Indeed, the private sector in Korea was fundamentally limited by the structural parameters set

by the state. The weakness of the private sector was dramatically echoed by the following lament of another top executive of the Korean overseas construction industry:

Until last year (1977), both the government and the people as a whole praised overseas contractors as national heroes and banners of modernization. All of sudden, they now regard us as the destroyers of the national economy by accusing as if we were wholly responsible for inflation, labor shortage, and other economic malaises. ( I. C. Um, president of Samwhan Corp., OCAK 1982: 46)

Summary: From the above discussion, we can deduce at least four major salient characteristics of state entrepreneurship. First, the Korean government's policy has been highly discretionary and particularistic. Instead of relying on market mechanisms or macro-economic tools, the government offered sector or firm specific incentives and disincentives to facilitate their entry and expansion in the Saudi market. In this way, the government was able to influence even micro-level decisions in line with the objectives of the government. Second, the Korean government skillfully orchestrated its mode of operation and was sensitive to the demands and needs of the private sector. As we have seen in its external political management, the government mobilized and manipulated the private sector to meet its foreign policy goals. And it was efficient, immediate, and sensitive in processing the grievances and needs emanating from the private sector. Third, Korean state entrepreneurship has been cyclical

rather than consistent and evolutionary. In particular, its insulative function revealed this trend. The pattern was chiefly shaped by political calculation of costs and benefits involving private interests and state objectives. Finally, in sharp contrast with many other industrial democratic countries, the Korean state was more than a mere mediator or regulator of conflicting private interests. It actively monitored environmental changes, calculated political costs and benefits, and controlled and coordinated the private sector.

State Entrepreneurship of Saudi Arabia: Changing State Interests, Eroding Political Base, and Saudi-ization

While Korea had specific interests and objectives in Saudi Arabia (i.e., export markets and oil), Saudi Arabia had no serious national interests in Korea which was neither a huge oil importer nor a crucial political or cultural ally. As we discussed in Chapter Four, what interested Saudi Arabia in Korea was the desire to diversify economic partners without undermining its security. Put differently, while Korean state interests in the Kingdom were conceived as vital, those of Saudi Arabia in Korea were not. This asymmetry of national interests has structured a different type of state entrepreneurship in their bilateral economic and political relationship with Korea. While Korea was aggressive and penetrative, Saudi Arabia was defensive and responsive.

Keeping this in mind, we trace below the responsive mechanism of Saudi entrepreneurship vis-a-vis the Korean government and firms.

Facilitative Functions: Although the Saudi government felt it profitable to promote economic ties with Korea, it did not provide Saudi businessmen with specific policies designed to attract Korean business partners. Incentives and disincentives available in the Kingdom as shaped by various royal decrees, laws, and administrative circulars were comprehensive and non-discriminatory.<sup>43</sup> It was within this comprehensive framework of incentives and disincentives that business transactions between Korea and Saudi businessmen have been structured. As we discussed in Chapter Five, the personalistic mode of conducting business in the Kingdom has played a crucial role in facilitating business ties with Koreans. But in general, such a personalistic business style was confined to the overall rules and parameters set by the government.

In order to expedite its development processes, the Saudi government provided domestic and foreign firms with a broad set of incentives.<sup>44</sup> In the initial phase of economic development, the Saudi government was not very sensitive to bid or import prices. National finances were in good shape with low absorptive capacity. For Saudi government officials, thus, the timing of availability or delivery was the important criterion on which contracts were awarded. This attracted foreign firms to a great

extent. In addition, since the Saudi government adhered to open market principles, there were no restrictions on foreign exchange and capital outflows, which was quite an unusual trend for a developing country. Thus, there were fewer risks and less bureaucratic redtape which in turn facilitated the operations of foreign firms in the Saudi market. Furthermore, the overall terms of contract in the Kingdom were extremely favorable to foreign firms. While other developing countries usually offered advance payments below 10% of contract amount, the Saudi government paid 20% - 30% until it changed its policy in 1982. Further import tariffs for equipment and materials were very low (3%) along with relatively swift pro-rata payments. And most importantly there were no specific policies which discriminated against foreign contractors and exporters. Both domestic and foreign businessmen competed on an equal basis. This might have been due to the absence of significant domestic industrial forces requiring such discriminatory provisions. Korean firms as well as firms from other countries profited from these facilitative policies.

With the introduction of the Foreign Capital Investment Law enacted by Royal Decree no. M/4 in 1978, the Saudi government offered extensive incentives for foreign firms engaging in joint-venture with Saudi companies. Provided that there is a minimum of 25% Saudi capital involved, the government allowed a 10-year tax holiday (corporate tax) for new joint-ventured industrial projects along with

complete exemption of import tariffs for plants, equipment and raw materials. Again the repatriation of profits was unrestricted. In particular, financial incentives were most attractive as illustrated in table 6-4. For the joint-ventures in the non-oil manufacturing sector, the Saudi Industrial Fund (SIF) gave loans up to 50% of needed capital, while another 25% was covered by commercial banks. The terms of financing were very favorable: 5-10 year spread term loans with no interest charged. Only an administrative service charge was imposed which amounted to 2.5% of total loan.<sup>45</sup> In case of hydro-carbon related basic industries, the Public Investment Fund (PIF) provided up to 60% of total capital needs with 3.6% interest for 5-10 year term provided that Saudi partners hold over 80% of share. Besides, public utilities (water, electricity, gas) were substantially subsidized by the government along with the provision of cheap land.

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table 6-4

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The most attractive part in this incentive package for foreign investors were the government guarantees for the survival of such ventures. The government specified that it would give highest preference to those goods and services produced by these joint-venture firms over foreign

Table 6-4: Incentives for Joint-Venture in Saudi Arabia<sup>1)</sup>

Sector	Incentives
Financial	1) Bank loan up to 75% of capital needs (SIDF 50% / commercial bank 25%) 2) Loan period: 5-10 years 3) Interest: none <sup>2)</sup>
Taxation	1) Exemption of corporate tax for 10 years 2) Exemption of import tariffs for plants, equipments, and raw materials
Land	1) Subsidized price for industrial site 2) M <sup>2</sup> : \$ 0.0242 (0.08 SR)
Public Utility	1) Subsidy for industrial water (M <sup>3</sup> : \$ 0.076 = 0.25 SR) 2) Subsidy for electricity (LWH: \$ 0.0152 = 0.05 SR) 3) Subsidy for natural gas
Marketing	1) Preferential purchasing by the government 2) Administrative support

1) These incentives are for the private manufacturing sector provided that there is a minimum of 25% Saudi capital involved.

2) By Islamic law, interest is forbidden. However, there is a service charge (2.5% of total loan).

Source: Foreign Capital Investment Law Royal Decree No. M14, 1978); Mallakh(1982); Korean Embassy in Jeddah(1983); Farsy(1982: 21-26) MEED(Nov. 9, 1979: 3-7, 41).

competitors within 20% price disparity. In addition to this preferential purchasing policy, the Saudi government pledged to impose protective tariffs on those import items up to 30% which would compete with domestic and joint-ventured firms ( Mallakh 1982; KIEI 1982; al-Farsy 1982: 21-26; Akhdar 1982:15-20; MEED Nov. 9, 1979:3-7).

How were these comprehensive and non-discretionary policies translated into specific preferential treatments of Korean firms so as to promote the growth of bilateral ties? Unlike Korea, there were no such particularistic policies. Put differently, it was not a set of policies, but informal and implicit favoritism that was responsible for the link between the comprehensive policy framework and preferential treatment of Korean firms. As we have discussed in Chapter Five, such favoritism originated from a unique form of the state-business relationship in Saudi Arabia. Personal connections and influences exercised by Saudi agents for Korean firms facilitated an easy link between comprehensive incentives and special treatment. Of course, the lubricative efforts by Korean firms in terms of non-conventional business practices also played a role in it.

Apart from this personalistic mode of conducting business, however, a number of facilitative factors emanated from the state itself. As the massive influx of Arab male manpower became a major security concern, the Saudi government tried to diversify the sources of expatriate manpower (refer to Chapter Four). Such a

diversification effort induced the Saudi government to grant preferential treatment to Korean labor in terms of entry visa-issuance and other administrative measures until 1979. The Saudi government perceived the value of Korean firms in terms of their state objectives such as the rapid construction of infrastructure. But when the Saudis discovered that Korean firms were having difficulties getting into the Saudi market (i.e., double counter-guarantee), it lifted the obstacles and accredited the Korean Foreign Exchange Bank as a legitimate counter-guarantee bank requiring no double guarantees from major international banks.

There were other types of facilitative incentives provided by the Saudi government. Some ministries and government agencies signalled directly or indirectly their preference for Korean firms to the Saudi private sector. Such preferential treatment depended on two primary motives. The first was related to the Saudi officials' personal perception of Korean firms. Many Saudi officials conceived of Korean firms as weak bargaining partners. They appeared to believe that it was easier for them to make Korean firms comply with their demands and needs even if they were based on their personal whims. This perception seemed to stem from two rationales: 1) Korean firms could not survive without doing business in the Kingdom, not only because of their immediate liquidity pressures, but also because there was no alternative market

as rich and diversified as Saudi Arabia; 2) the Korean government was too weak to protect their private firms' interest in Saudi Arabia in terms of bargaining because it too depended on the Kingdom for oil and export markets. A bureaucrat-turned businessman described this aspect in the following way ;

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I don't like American firms. They are arrogant, nitty-pickers, difficult to control. Whenever problems ensue which they cannot solve with us, they petition their embassy and government, creating headaches. But Korean firms are not like that. They always comply with our directives. If they fail to do so, their government backs us up. Koreans are really good partners. ( Interview with Sheikh Sabri Gabel, Jeddah, March. 21, 1983)

The second facilitative factor depended on more macro-political and foreign policy considerations. Traditionally, Saudi Arabia depended on the US for its military modernization. In particular, COE (US Army Corps of Engineers) and some private American firms such as Vinnel and Bechtel played substantial roles in defense build-up of the Kingdom. But the National Guard was a different case. Its commander, prince Abdullah, was known to be conservative and anti-American. Until he became Crown Prince, the budget for the National Guard was not adequate to initiate massive modernization, compared with the regular army under prince Sultan. However, when he became crown prince and was able to wield more political influence, the National Guard underwent a massive build-up. Military barracks were rebuilt and new bases were established. His personal suspicion and dislike of

American firms induced him to give preferential treatment to Korean firms. In fact, Korean firms obtained a great portion of National Guard projects (MEED July 3 1981:36).<sup>48</sup> Even prince Sultan and senior officials at the Ministry of Defense and Aviation favored Korean firms in selective projects sensitive to national security. The reason was that if American firms were involved, there might be a high probability of information leaking to the Israelis.<sup>49</sup>

Korean firms were thus preferentially invited to many tenders. Compared with other nations' firms, Korean firms won a good portion of contracts on a negotiated basis. In addition, incentives provided through Foreign Capital Investment machinery led Korean firms into various industrial joint-ventures with Saudi firms (refer to Chapter Three for specifics).

Political Receptivity: There was no particular reason for the Saudi government to pursue active external political management regarding Korea since no Saudi political or business interests were at stake in Korea, nor any compelling national interest to reshape its foreign policy in the area. As we shall see below, the Saudi government was largely responsive to Korean demands and requests, rather than initiative. However, the level of such a political receptivity can be a good barometer through which we can figure out the Saudi attitude toward the Korean government and firms. This receptivity can be examined by looking into its foreign policy, the level of

personal diplomacy, and concessions.

The primary foreign policy concern of the Korean government was its diplomatic competition with North Korea. The acquisition of international recognition as the sole and legitimate representative in the Korean peninsular and the isolation of North Korea from the international community constituted the core of Korean foreign policy. Regarding this, Saudi Arabia was very sympathetic with the Korean position. In fact, until the early 1970s, the Saudi government maintained a neutral position in the North-South diplomatic competition. For example, Saudi Arabia continued to cast votes of absentee in UN regarding the Korean issue. However, this neutral attitude sharply changed through the 1970s. Both in the United Nations and in the Non-Aligned Movement, the Kingdom showed strong support for South Korean causes. Sometimes, it was instrumental in winning support from other Arab and Islamic countries on behalf of Seoul.

Ambassador Zein Dabbagh at the Saudi Embassy in Tokyo, who has ambassadorial responsibilities in Korea, elaborated the rationale behind the Saudi's diplomatic support for Korea as follows:

We have two justifiable reasons to support Korea. First, our Kingdom is the center of Islam which opposes communist ideology and aggression. Korea is fighting against communist North Korea. Thus, we have every reason to help Korea. Second, nobody can deny the fact that Korea contributed to economic development of the Kingdom with good

intentions. Our diplomatic support is a natural reward for such a contribution. (Interview, Tokyo, Jan. 23, 1983)

This position was further assured by Saudi leaders. When Prince Naif visited Korea in 1979, he made clear the Saudi position in a press conference that "our Kingdom has never thought of having diplomatic tie with North Korea." (Dong Ah Il Bo, July 17, 1979) Again in 1980 on the occasion of then president Choi's state visit to the Kingdom, the late King Khaled proclaimed in the joint-communicate that "we fully support the Korean government's efforts to bring about peace and stability in the Korean Peninsular through peaceful unification." (Dong Ah Il Bo, 14 may 1980)

Saudi support was not limited to posture on the North-South Korean issue. It also helped the Korean government to satisfy other foreign policy objectives in the Middle East. This involved the consolidation of wide support from Islamic countries and diplomatic normalization with progressive countries in the region over which Saudi Arabia could extend its leverage. Specifically, the Korean government sought Saudi help in normalizing its diplomatic ties with Iraq and North Yemen. The Saudi response was favorable. And it facilitated Koreans ties with these countries by utilizing high-powered diplomacy. <sup>50</sup>

Apart from this diplomatic support, the Saudi government also responded favorably to personal diplomacy. From 1974 to 1981, over 50 cabinet-level

members visited Korea. As explained in the previous section, the majority of these visits were solicited by the Korean government and firms. One interesting aspect of this personal diplomacy is the high concentration of visits by Saudi cabinet members involved in economic affairs. With the exception of Prince Naif (the Interior Minister), three military delegations, two mayors (Jeddah and Damman), and one deputy minister of religious affairs (Haji and Endowment), all others were from economic ministries or related government agencies. In 1978 alone 10 economic ministers or deputies visited Korea. Among them, Planning Minister Hisham Nazer was a most frequent visitor (three times). This pattern of personal diplomacy indicates that economic matters constituted the core of the Saudi-Korean relationship and that economic technocrats were quite sensitive and sympathetic to Korea (Korean Ministry of Foreign Affairs 1983).

In particular, Prince Naif's visit to Korea in 1979 deserves our special attention, not only because of his powerful position in the Kingdom<sup>51</sup>, but also because of his new attitude toward the Saudi-Korean relationship. Despite the Korean government's interest in his favor and influence over economic issues, he suggested to the Korean government officials that the scope of bilateral cooperation should go beyond the economic areas. In this context he agreed to pursue security cooperation with the Korean government. He also promised to support the establishment of an Islamic college in Korea. He kept his promise despite opposition

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from fellow cabinet members. By Royal Order no. 1049-8 dated April 23, 1981, the Saudi government officially committed itself to the establishment of the Islamic College. Of course, this decision is not unrelated to Saudi's domestic political reasons, that is, the enhancement of legitimacy through overseas Islamic propagation. But pledging \$28 million for a Muslim community of less than 20,000 implied a special political meaning.

The Saudi government also demonstrated a number of other goodwill gestures and concessions in its relationship with Korea. As we shall see in the concluding part of this chapter, Korea was one of the first countries with which the Kingdom signed an agreement on economic and technical cooperation (July 1974). That agreement was signed almost one year before that with the US (Feb. 1975). And it provided the Korean government with a valuable channel of communication and bargaining with Saudis on the official level. When the wave of the second oil shock hit Korea, the Saudi government showed its goodwill by agreeing to supply 50,000 b/d on government to government basis (G-G) and additional 50,000 b/d on D-D basis through a Korean private firm. When neighboring Arab countries' media and Western firms charged that Korean workers were de facto para-troopers, Saudi leaders strongly denied and defended the necessity of Korean workers by praising their efficiency, discipline, and capacity for hard-working.

In sum, though limited and passive in the sense that their actions followed upon requests from the Korean side, the Saudi government was responsive and sincere in dealing with. As we shall discuss below, however, their cooperative attitude began to erode early in 1980. When the Saudi government lifted the insulative shield (formal or informal) protecting Koreans, and modified its political calculations, the cooperative relationship began to transform into a conflictive one.

Insulative Functions: Eroding Political Bases?: It is not an exaggeration to say that the Korean-Saudi connection between 1974 and 1979 had constituted a happy honeymoon. Korea had every reason to exploit Saudi wealth and to secure oil, while Saudi Arabia was endowed with a set of domestic and external pre-conditions to induce actively the Koreans (refer to Chapter Four). But as time went on, the environment changed, leading to different calculations of interests. "We always seek the best which suit our interests", Prince Naif stated in his welcoming address to visiting Korean Interior Minister Suh. He further added, "Those who come to this country have to respect our Islamic faith and our traditions." (al-Riyadh 11 May 1981) What was implied in his statement was a warning that those who do not suit Saudi interests would not be welcome in the Kingdom. But such a warning was then becoming a concrete reality. Newly changing economic and business climates in the Kingdom were producing a clash of interests between

Koreans and Saudis, profoundly undermining once strong political support.

The conflict of interest and subsequent erosion of the political base came above all from Saudi agents who had previously formed strong business connections in the Kingdom on behalf of Korean firms. Early in the 1980s, those Saudi agents who depended on commissions underwent a metamorphosis from mere collectors of agent fees to active businessmen, opening their own contracting firms. Two factors were primarily responsible for this transformation. One was the rapidly changing business psychology of Saudi entrepreneurs. Walid bin Zagr, a prominent Saudi businessman, epitomized such a change in the following remark:

We cannot have a nation of people with no sense of responsibility and no work involvement. Work would enable them to be productive and to produce material wealth ahead of their rising expectations . . . The alternative will make the people hoarders, collectors of titles and greedy in a land which surrounds them with others who are without work and without anything to live with. (MEED April 24, 1981: 41)

The author's interviews with Saudi businessmen revealed that a significant number of them shared these sentiments. In particular, they felt that if Korean contractors could do the job, why not Saudis?, and that they should not give away their wealth and business opportunities to foreigners thus debasing themselves as subcontractors or commission agents.

Second, there was an extensive policy reform by the

Saudi government to support and satisfy such psychological changes on the part of Saudi businessmen. As we shall see below, by setting economic self-reliance as one of the primary goals of the Third Five Plan under the banner of the Saudi-ization,<sup>53</sup> the Saudi government provided well intentioned local businessmen with all kinds of incentives. Massive industrial loans (SR 113 billion during 1977-1983) were poured into the private sector, leading to the birth of 150,000 new firms during the same period (Saudi Gazette March 14, 1983). Extensive preferential treatments in contracting, importing, and other business areas were granted to Saudi local firms through the enactment of various laws and royal decrees.

The consequence of these measures was the advent of a new breed of entrepreneurs as well as a further sophistication of the existing businessmen. They have become more competitive and efficient. As illustrated in table 6-5, Saudi local contractors have become extremely competitive. Prior to 1977, there were almost no self-pledged local contractors. But by 1980, their share reached almost a half of the Saudi contracting market. In addition, the size of local firms has surprisingly grown. Before 1977, there were only a few local firms which could bid for tenders over SR 200 million (Class A contractors by the Saudi classification system).<sup>54</sup> But the number of class A firms increased to 24 by 1982. In addition, 64 local firms could bid for tenders up to a value of SR 200

million, while 98 firms up to SR 50 million.

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table 6-5

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The transformation of once passive commission agents into aggressive contractors soon reversed the previous complementary relationship. Local Saudi firms began to accuse Korean firms of dumping, and appealed the Saudi government to be more restrictive against Korean firms' business operation in the Kingdom. <sup>55</sup>

Not all agents became contractors, however. A good portion of Saudi businessmen continue to serve as Korean firms' agents and brokers. Nonetheless, their perception of Korean firms has changed, causing them to lose confidence in Koreans. There are numerous reasons for this deterioration. For example, it has become much more common for Korean firms to fail to pay agents' fees and other obligations because of their excessive price undercutting and declining profit margins. This practice has infuriated many Saudi sponsors. Further, the Korean government's contracting license system created negative impacts among Saudi local agents. Some agents started to make outright complaints against the Korean government when they lost their business by the latter's strict licensing and careful coordination. Even if some agents spotted lucrative jobs for Korean firms, the Korean government's intervention

Table 6-5: The Evolving Pattern of Saudi Local Firms' Competitiveness: A Comparison with Korean Firms

Year	Tender (No. of case)	Lowest Bids	
		Local Firms	Korean Firms
1977	111	45(44%)	32(29%)
1978	183	86(47%)	63(34%)
1979	244	115(47%)	69(28%)
1980	254	125(49%)	108(37%)
1981	429	199(46%)	134(31%)

Source: Korean Embassy in Jeddah(1983)

often did not allow their clients to bid for those tenders. In addition, increasing liquidity problems faced by Korean firms led to a feeling of uncertainty among Saudi sponsors. Finally, the Korean government's excessive control of foreign employment of Korean workers also gave rise to complaints from Saudis. A great number of Saudis wanted to hire Korean labor directly. However, the government regulation prevented such direct employment, creating Saudi opposition.

Korean firms began to lose their support not only from these agents, sponsors, and brokers, but also from the suq (market) merchants and local manufacturer who began to make explicit complaints against Korean firms. Their position was reflected in the following statements during the author's interviews in Saudi Arabia : "Koreans are greedy."; " They behave like little neo-imperialists."; "They took benefits from us, but never return them." A Saudi local newspaper synthesized such sentiments as follows:

Some Saudis get the impression that Koreans take everything from us, but do not give a thing in return. They have never seen a Korean buying a piece of bread or a pair of trousers or a present for his family when going back home. Koreans are different from other workers. (al Jazirah, August 18, 1981)

A much stronger complaint came particularly from local manufacturers of construction materials. Owing to intensive government support, during the later part of the 1970s, this industrial sector had developed to the extent

that surplus capacity became the major policy issue. Thus, local firms suffered from market saturation in pre-cast cement, steel, and aluminum etc. But Korean firms, major buyers of these items, could have been sensitive to this market saturation. Due to the Korean government's efforts to link overseas construction and exports of construction materials, however, Korean firms were inclined to buy from Korean exporters. <sup>58</sup> In addition, when they had to buy those goods from Western countries, they did not go through Saudi importers because of high prices. They posted their purchasing officers in US and U.K. and imported directly. This behavior outraged both Saudi merchants and the government. The Saudi response was the issuance of a decree to prohibit direct import activities by foreign firms stationed in the Kingdom, and strictly enforced a policy of direct purchase from Saudi importers or manufacturers as of January 23 1982.

In relation to this awakening of Saudi businessmen, an interesting phenomenon began to emerge. This was the strengthening of the roles of the Chamber of Commerce and Industry in aggregating, converging business interests and communicating with the government. According to the previous code of the Chamber of Commerce and Industry, local and/or foreign firms' registration with the Chamber was not compulsory, though recommended. But later the Ministry of Finance and National Economy amended it and strictly enforced the provision of compulsory

59 registration. This gave the Chamber more leverage to monitor and control foreign business activities which go against interests of the local business community. As the Saudi government shifted the nature and direction of the national economy from public sector-led to private sector-led, the Chamber's function became more powerful in expressing collective interests of the business community vis-a-vis the Saudi government and foreign firms, including Korean firms.

60 This deteriorating image of Koreans among Saudi businessmen was further escalated into other social arenas as well. Some local religious leaders began to complain about Christian missionary activities in Korean work camps in the Kingdom. They even attributed increasing labor disputes among Korean workers to such activities. 61 College students interviewed by the author, on the other hand, showed negative feelings to Korean workers and firms. Their grievances were similar to those of the sug merchants. They charged that Koreans are greedy and imperialistic. "We chose Koreans in fear of Western firms. But now what is the difference between Koreans and Westerners?" one student expressed, "They give nothing 62 in return; no technology and no manpower training."

The most serious blow came from the gradual erosion of political support base among Saudi elites. As discussed in Chapters Four and Five, their positive perception of Koreans accounted for the successful entry and expansion of Korean firms to the large extent. Nonetheless, a gradual

shift in their perception emerged in correspondence to their changing state interests. Al-Nuwaiser, Saudi Ambassador to Seoul,<sup>63</sup> described such perceptual shift in his interview with a local Arab Newspaper: "All merchants, beginners as well as the experienced, should be cautious about their dealings with Koreans." (al-Jazirah, August 18, 1981 my emphasis) His warning indeed signalled a profound change in the Korean-Saudi Arabian bilateral relationship from that of confidence and cooperation to that of caution and conflict. What have been the underlying reasons for this change?

Above all the emergence of conflicts of interests between Saudi locals and Koreans above discussed was crucially responsible for this shift. While new local businessmen wanted more share in their own market, Korean firms were reluctant to make concessions. The Saudi government initiated extensive efforts to "Saudi-ize" the national economy in labor, contract, and merchandise markets. But Koreans were less cooperative. Even Prince Naif, who has been regarded as one of few Saudi leaders explicitly sympathetic with Korea, complained about this matter to his Korean counterpart, Interior Minister Suh, who was visiting the Kingdom 1982. Relaying grievances compiled from the Chamber of Commerce, the prince pointed out that Korean firms were neither helpful in the Saudi national economy due to their purposeful avoidance of purchasing goods and services from local merchants, nor

cooperative in training local manpower.

Another equally devastating factor was the Saudi realization and critique of the Korean government's excessive intervention in the private sector. Saudi officials as well as business leaders strongly protested the Korean government's control and monitoring of its private firms in the Saudi market. The contracting licensing and classification system policies were the targets. The Saudi position was clear: Korea's interventionist policies not only violate free market principles of the Saudi economy, but also hurt Saudi government as well as local business interests. Since these policies were designed to regulate over-competition and undue price-undercutting among Korean firms, they were sufficed to cause Saudi government's grievances who wanted cheap prices through such free competition. Furthermore, local agents who were hurt by this measure strongly pressurized the Saudi government to take political actions to prevent such practices.

Finally, political and social instabilities ensued following the assassination of president Park in late 1979 and 1980 negatively affected Saudi elites' perception. For them, the strength and capability of the Korean government was the primary driving force for Korean firms' success in the Kingdom. But Saudi elites began to suspect the Korean government's strength and ability to control over business and labor with the erosion of strong political leadership under the Park regime. This suspicion

dovetailed with the increasing frequency of labor disputes in Korean work camps in the Kingdom. Especially, as labor disputes became violent and large in scale, involving the intervention not only from local police forces but also from the National Guard, the suspicion turned into an anxiety that such labor disputes may escalate to expatriate workers from other countries, eventually spreading negative demonstration effects to Saudi local workers

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Given the fact that Saudis initially preferred Koreans to others chiefly because of its strong control over the private sector and cheap and disciplined labor, such a perceptual change was tantamount to a virtual suspension of cooperative and preferential relationship between the two countries. The Korean government detected the criticality of the issue and managed to realize the state visit by President Choi in 1980, despite some opposition from within. 66 As mentioned earlier, the state visit helped to improve such a declining image tentatively, but could not reverse the trend as a whole. For all active invitation and lobbying by the Korean government, Saudi senior officials' visits to Korea sharply dropped. King Fahd's earlier plan to visit Korea on his way to Japan and US was also scrapped despite Koreans' desperate efforts. 67  
Along with this, the Saudis, both the government and private sector, have become much more sensitive to changes in Korean internal politics. Such sensitivity was

revealed in its invitation of a head of Korean opposition party to the Kingdom 1982, which was very rare by conventional Saudi policy.  
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On top of these, the weakened business performance of Korean firms further aggravated the Saudi technocrats' skepticism over Koreans. Beginning in 1979, a number of Korean firms went bankrupt (refer to early section). As the Saudi contract market became more competitive and the Korean government showed signs of gradual reduction in its support, wild rumours on liquidity problems of major Korean contractors circulated among local businessmen, leading to a loss of confidence of these firms on the part of Saudi technocrats. The Kong Young scandal exacerbated the situation. But a more devastating problem derived from the weakened performance of a number of Korean contractors. As of 1983, 28 projects by 20 Korean contractors, including the notorious al Kharji housing project,<sup>69</sup> either lagged behind their contract schedules or was claimed by Saudi clients (mostly government agencies) for various mistakes. To Saudi bureaucrats, this implied that Korean firms were no longer reliable business partners.

Apart from political and business factors, external pressures also forced Saudi leaders to re-think their close ties with Korea. The high visibility of the Korean presence in the Kingdom invited all kinds of demagogues and grievances from outside. Mass media and intellectuals in neighboring countries began to speculate that Korean workers were to be used as paratroop mercenaries in case

of emergency. This accusation grew out the Saudi labor policy favoring non-Arab expatriate manpower (Ayubi 1982; Dessouki 1981). For Saudi Arabia whose primary foreign policy objective is to maintain leadership in the Arab world, such accusation was critical. Although Saudi leaders denied the charge and advocated the continued presence of Korean labor, they began to slow down the influx of Korean workers. Poor Islamic countries also began to claim their share of the Kingdom's wealth. By pointing out that Saudi Arabia was the global patron of Islam, these countries requested more preferential treatment in manpower imports and contract business either through bilateral channels or through the Organization of Islamic Conference. Indonesia, Bangladesh, Pakistan, and Malaysia were particularly vocal protestors in this matter.<sup>70</sup> On the other hand, foreign (mostly Western) consulting firms, employed by the Saudi government to supervise and assess contracts, began to interfere with Korean firms either by unusually strict work supervision or by the designation of specifications disadvantageous to Korean firms. Their motive was clear: to deter the expansion of Korean firms and to enhance their own national firms.<sup>71</sup>

Not all Saudi elites shared this negative image of Koreans. Some senior officials, especially from the Planning, Finance and Foreign Ministries, were still favorable to Korean firms and the Korean government.

Sympathetic to the Korean dilemma, a well placed senior official in the Planning Ministry described the overall picture as follows:

Saudi businessmen are crying wolves and born agitators. They want to enrich themselves under government protection and subsidy, rather than through market competition. Koreans are the victims of Saudi merchants' greed and parochialism. Who would have worked harder than Koreans in the economic development of Saudi Arabia. They took marginal profits and worked for the Kingdom with love and loyalty. Where else can we find such an economic partner? (Interview, Riyadh Jan. 29, 1982)

But the number of bureaucrats who shared this sentiment was small, and the intensity of their preference was not strong enough to defend Koreans in political and bureaucratic battles. <sup>72</sup> Even if they did, the tone and direction of the Saudi national economy had already begun to change. With the initiation of the Third Plan, a strong, nationalistic, and inward-looking wind began to blow, entirely reshaping market conditions in the Kingdom. And the active implementation of the Saudi-ization of the national economy ensued.

Saudi-ization and Its Impacts: Saudi-ization simply refers to a set of government policies designed to reduce dependence on foreign firms and expatriate manpower as well as to induce more active local participation in economic development. Abdul Rahman al-Zamil, the Minister of Commerce, justified this policy orientation as follows:

During the development in the last eight years, we were not under so much pressure to do this (Saudi-ization). The Saudi business community had not developed. We needed the foreign firms to participate actively in the development process, and we needed Saudi and foreign firms to bid on the same basis. But we have reached the stage of development where Saudi business matters. . . .The trend is clear---Saudi-ization is taking place. (MEED July 1981, Special Report on Saudi Arabia :33)

The maturity of the Saudi business community alone did not give rise to this nationalistic policy orientation. The overall business practices by expatriate firms were partly responsible for it. A keen observer of Saudi business scene linked foreign firms' business practices to the birth of Saudi-ization in the following way:

The worst example from the point of view of Saudi Arabia is where the Saudi partner has little or no participation in the management of that (joint) company. The foreign company has no commitment to Saudi Arabia. All the costing, the design, material management---is done in the home country. . . .The Saudis are left with profits in the short term, but the community is left with nothing. I think this is one of the reasons to recent Saudi legislation that has put the accent on Saudi participation. (MEED Nov. 11, 1983)

Indeed, Saudi-ization was a "de-dependence" strategy. It was extensive and well coordinated. Royal decrees and administrative directives were issued in a wide range of business areas to implement this policy. In manpower, for example, the Saudi government set up an ambitious plan. As table 6-6 illustrates, the government tried to restrict the average annual growth rate of expatriate labor to 0.2%

during the Third Plan period ( i.e., only 9,000 persons increase during 1979-1985), which contrasted sharply with a 1.2% increase of native manpower. In other words, the Saudi government opted for replacing the maximum number of foreign workers with Saudis in the minimum length of time in all sectors: banking, commerce, manufacturing, the oil industry and farming (MEED April 24, 1981: 41; the Third Plan; Mallakh 1982).

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table 6-6

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In order to achieve this goal, the Saudi government enforced various policy measures. First, it promulgated an obligatory rule that all foreign contractors had to employ at least 5%-10% local manpower. (KIEI 1981) Second, with the enactment of the Rules and Procedures for the Consulting Engineering Profession Practice in 1982, the government effectively blocked the inflow of foreign consultants and made room for broader participation of local engineers and consultants. Finally, foreign labor migration related policies became more stringent. By applying a tight quota system controlled by the Ministry of Interior, the government either delayed the entry of the already approved migrant workers or in certain cases substantially reduced the number of slots allocated for

Table 6-6: Saudi Manpower Supply Plan

Unit: 1000 persons

	Number of Employment			Average annual growth rate
	79/80	84/85	Increase	
Total	2,471	2,626	155	1.2%
Saudis	1,411	1,557	146	1.9%
Expatriate Labor	1,060	1,069	9	0.2%

Source: Third Development Plan of Saudi Arabia

various manpower exporting countries. In addition, from Nov. 1981 the government classified the types of expatriate labor and requested the prospective immigrant workers to document their skills with official certificates issued by the sending countries' governments ( S. Lee 1982:21).

In the contracting market as well, protectionist policies prevailed, favoring local companies in various government tenders. For simple construction and civil engineering projects, the Saudi government invited local firms almost exclusively to its tenders. In particular, the Jubail and Yanbu Royal Commission from which major tenders emerged gave local firms special treatment, and as a result, over a half of the tenders went to local firms as of 1982 (Lee 1982: 23). At the same time, the Saudi government devised another tactic to protect local interests. This consisted of splitting up large packages and dividing them into smaller projects. The motive for this de-packing was clear. Since local firms were relatively small and not yet ready to take over large and technology-intensive tenders, the government split them up and allowed local contractors to jump in (Mallakh 1982:408-409). In addition, a 10% incentive rule was strictly applied. In order to induce the participation of local contractors more competitively, the Saudi government enforced a rule that allowed local firms to win contracts even if their bid price was 10% higher than the lowest bid price offered by foreign contractors. Another major policy

element in the contracting business that evolved out of Saudi-ization was a '30% subcontracting rule'. By royal decrees issued in September 1981 and March 1983, it became "obligatory for foreign contractors to award not less than 30% of their contracted projects to Saudi contractors." (Saudi Gazette March 29 1983)

By the same decrees, regulation in commerce and trade was strengthened. Foreign contractors must buy their machineries, equipment, and tools only from Saudi local agents. It was also stipulated that foreign contractors or commercial establishments must deal exclusively with local firms for transport, insurance, bank services, land leases and food items. In addition, the Saudi government imposed 20% import tariffs for 33 items which Saudi local manufacturers began to produce, ranging from foodstuffs to construction materials and machinery (Korean Ministry of Commerce 1983). Saudi-ization was also applied in the oil industry and finance. In 1980, the Saudi government pledged to nationalize the equity of the ARAMCO by 100%. And by 1982 all the branches of foreign banks were Saudi-ized in the form of joint-ventures where Saudi partners held majority share.

The impact of this Saudi-ization on Korean firms was seriously damaging. The revised manpower policy limited and delayed the issuance of block visas to Korean workers which made it difficult for Korean firms to mobilize manpower in time. For example, as of 1982, the Saudi government's daily visa quota for Korean workers satisfied only 69.4% of total

manpower needs by Korean firms (Lee 1982: 40) Such delays and limitations were largely responsible for various defaults in work performance such as delayed contract schedules. The '10% incentive rule' cost Korean firms some hundreds of million of dollars worth of contracts (total 28 cases) for the 1981-1983 period. At the same time, the '30% subcontracting rule' virtually invalidated the Korean government's policy of classifying contractors into prime and subcontractors, eventually leading to weakened government control over Korean contractors. The "Buying Saudi" policy resulted in a sharp reduction in Korean exports of some key items such as construction materials and equipment. But the more worrisome aspect of this Saudi-ization policy was not the losses cited above, but the gloomy future it forecasts. The golden days for Korean firms are about to be over.

Summary: The Saudi state entrepreneurship illustrated above is contrasted sharply with that of Korea. While Korea pursued target and sector specific facilitative policies, Saudi Arabia adopted non-discretionary and comprehensive policies in facilitating Korean firms' entry and expansion in the Saudi market. In terms of external political management, the Saudi government was largely responsive to Korean requests and initiatives. Third, the Saudi's insulative role in protecting Korean interests faded away along with changing calculation of state interests and objectives. When conflicts of interest

arose, the insulative shield set up through business connections and positive perception of technocrats drastically eroded. Finally, as in Korea, it was the Saudi government that conditioned and shaped the tone and direction of market conditions, critically affecting the behavior of the private sector. The initiation and implementation of the Saudi-ization policy eloquently proved this point.

Conflicts, Power Asymmetry, and New Direction  
in the Saudi-Korean Connection

By way of conclusion, we examine next the consequences of our growing rising conflicts and their impact on Saudi-Korean bilateral relations. So far, we have seen that although the private sectors of both countries played a substantial role in shaping the process of bilateral economic transactions, the ultimate determinant responsible for the direction and volume of these bilateral flows was a variety of government policies pursued by both parties. The state authorities of Korea and Saudi Arabia exercised enormous power and influence in conditioning business behavior of the private sector either through particularistic and discretionary intervention (Korea), or through the application of comprehensive and non-discretionary policies (Saudi Arabia). The rationale behind this intervention or entrepreneurial exercise was

the maximization of state interests or objectives which were basically contingent upon the changing situational contexts. State objectives such as political legitimacy, security, economic stability (e.g., curbing inflation or improving balance of payments), rapid economic growth etc. usually intermingled and dynamically conditioned state behavior.

Although the pursuit of these objectives had brought about a pattern of cooperation and stability between two countries in the early stages, the congenial relationship did not last long. As the state's calculation of the costs and benefits involved in a bilateral relation changed, the relationship fell apart. In other words, a syndrome of "complex interdependence" (Keohane and Nye 1977) began to characterize the bilateral relationship. Facing such a syndrome, the Korean government, the primary beneficiary of this bilateral tie, pursued active diplomacy and bargaining in order to prevent the deterioration of the friendly relationship as well as to head off pending conflicts of interest. In so doing, Korea deployed a variety of tactics: cheating, appeasement, political consolidation, centralized negotiation, and concessions.

1) Cheating: This tactic was particularly visible in the case of the contract licensing policy. In order to avoid the negative consequences associated with this interventionist policy and to keep it secret, the Korean government punished those Korean contractors who leaked

such information. Furthermore, the government classified as confidential most of the information related to contractors business activities in the Kingdom. This was to circumvent any potential restrictive measures on the part of the Saudi government or to deter the advent of countervailing strategies by competing foreign or Saudi local firms. <sup>75</sup> In addition, although Korea formally took the side of the Iraq-Saudi-Gulf states group in the Gulf war, it, especially the Korean private sector, could not give up the Iranian market. Again the Korean government tacitly allowed Korean firms to export to Iran.

2) Appeasement: As noted earlier, the most conspicuous form of appeasement was Korea's public pro-Arab position. The tilt toward Iraq and other Arab states in the Iran-Iraq war was another indication of Korean efforts to appease Saudi Arabia. But both cases involved risks in Korea's calculation of opportunity costs. The former invited opposition from the US, the key Korean ally, particularly from the powerful Jewish lobby which could negatively affect American foreign policy toward Korea. The latter implied the loss of the lucrative Iranian market. In addition, the pro-Iraqi posture favored the diplomatic pre-dominance of North Korea in Iran. <sup>76</sup> Despite these costs, the Korean government pursued such tactics to appease the Saudis and to enhance economic cooperation with them.

3) Political Consolidation: In order to enhance cooperation as well as to avoid conflicts, the Korean

government relied heavily on the consolidation of its political support in the Kingdom. By actively inviting Saudi ruling elites to Korea on the one hand and initiating personal diplomacy through the frequent dispatch of senior Korean officials on the other, Korea tried to create strong political ties in the Kingdom. The result was a high concentration of elite linkages along functional lines. Rather than obtaining broad, grass-roots-based political support, the Korean government opted to consolidate its political backing from those who were functionally in charge of short-term interests or held a key to pending bilateral conflicts.

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4) Centralized Negotiation Style: Apart from routine diplomatic channels, the Saudi Arabia-Korea Joint Economic Committee, which was formed out of the Agreement on Economic and Technical Cooperation signed on July 1974, has provided the key negotiation machinery between the two countries. The Korean government attempted to take full advantage of this Committee in advancing its official and private interests. Korea virtually dumped almost every issue, economic or otherwise, on the negotiation table of this Committee meeting, which was held annually, alternately in Seoul and Jeddah. The Korean calculation was to utilize this Committee as a centralized means of negotiation and communication covering the entire range of pending issues between the two countries in order to compensate for its weak political linkages with Saudi

Arabia.

5) Concessions: Finally, the Korean government tried to make various concessions to Saudi Arabia in order to induce more cooperation. As noted earlier, the Korean government donated land sites for the Islamic community in Korea. Numerous proposals and commitments were also made for manpower training as well as in the fields of technical and scientific cooperation.

Despite all of this, the bargaining outcomes were not favorable to Korea. They did not allow Korea to evade the compliance with Saudi demands. When the Saudi government threatened to block Korean business interests in connection with the Korean government's contracting licensing policy, the latter complied with the Saudi request by scrapping the policy and by liberalizing the overseas construction industry from heavy government intervention. When the Saudi government threatened to sever diplomatic tie with Korea after learning about Korean exports of military goods to Iran, Korea satisfied the Saudi demands by pledging a tighter monitoring of Korean firms export activities to Iran.<sup>79</sup> Political appeasement helped the Koreans, but not that much. For Saudi Arabia, Korean diplomatic support was largely symbolic and marginal. In addition, such appeasement was traded by Saudi support for Korea's diplomatic contest with North Korea in the Middle East and in other Islamic countries. The political consolidation tactic was not effective either. The Korean government failed to consolidate a broad political support from Saudi

population, and attached too many burdens and strings to actual or potential pro-Korean elites in Saudi Arabia. One Korean diplomat posted in Jeddah confessed this failure in the following way :

The Kingdom is the most difficult post I have ever held. For example, it is almost impossible to open channels of communication with senior Saudi officials, at the Foreign Ministry or elsewhere. Of course, this is partly due to bureaucratic redtape. But there is another critical reason. They purposefully avoid meeting us. Even some officials, whom we consider sympathetic to Koreans by virtue of their previous visits to Korea, show such a tendency. But it is quite understandable. Whenever we meet them, we seek their favor ranging from the release of the jailed illegal Korean workers to sales promotion. How can Saudi officials love beggar-salesmen diplomats? (Interview, Jeddah March 18, 1983)

The efforts to make the Joint-Committee the key channel of negotiation did not work either. The primary obstacle was, of course, the Korean attempt to politicize the Committee by inserting non-economic issues such as the release of jailed businessmen implicated in bribery scandals and diplomatic support for the South Korean position in the international fora. But the more important barrier was the nature of foreign policy-making in Saudi Arabia per se. In the Kingdom, with the exception of such key foreign policy issues as the Arab-Israeli Conflict, Gulf Security, and Islamic solidarity in which the authority of the King and/or Crown Prince is predominant, other issues are highly fragmented across various bureaucratic agencies. Certainly, the Korean issues were

not of high priority, eventually letting fragmented bureaucratic interests prevail. It was this decision-making structure that kept the Saudi responses decentralized and compartmentalized. Saudi delegates led by Sheikh Abdullah Ali Reza had always tried to divert those issues from the negotiation table of the Joint-Committee to relevant government agencies and the private sectors. This stands in sharp contrast to Saudi efforts to politicise other joint-committees such as the Saudi Arabian-US Joint Economic Commission. In dealing with US, the Saudis have tried to politicize the Commission to the maximum. <sup>81</sup> The other Korean option-- of concession-- did not work out either. When the Korean government offered scholarships, for example, not a single Saudi student applied. Furthermore, the prevalence of an "Indian Chieftain" psychology and the underestimation of Korea's technological level lessened the effectiveness of this tactic.

Such were the unavoidable consequence of power asymmetry between the two countries: power measured in contextual or structural terms, <sup>82</sup> not in behavioral. In behavioral terms, Korea is by far stronger than Saudi Arabia: a larger population, superior military force, diversified industrial capability, and even superior strategic preparedness. The problem did not consist in the asymmetry in these behavioral dimensions of power, but lay in the contextual or structural elements of power. Such contextual elements can be delineated as the erosion of complementarity in state interests, Korea's excessive

dependence on Saudi Arabia, and difference in decision-making or bargaining styles.

The priority of Saudi Arabia's state interests can be summarized as follows: the preservation of regime security from domestic destabilizing factors as well as external threats; prevention of the emergence of a hostile alliance to the North; supporting the security of friendly governments and general stability in the Arabian peninsular, Gulf, and nearby areas; settlement of the Arab-Israeli conflict in a manner consonant with the preservation of Islamic and Arab interests; economic development to improve the quality of life of Saudi population ( McLaurin 1982:221-223 ; Dawisha 1978:133-134; Quandt 1981; Abir 1983). Viewed from this list of Saudi interests, Korea had little to offer. In the initial stage, Korea alleviated an expatriate labor-related security problem to some extent as well as contributed to economic development. But by the 1980s, complementarity of this kind has diminished. Korean manpower has become a liability rather than an asset because of frequent labor disputes, high wage costs, and political accusations targeted at Korean labor from neighboring countries. Regarding its economic contribution, Korea afforded little of value to the Kingdom as the nature of economic development changed from labor-intensive infrastructure building to capital- and technology-intensive industrialization. Furthermore, the growth of local firms

and the availability of more competitive new firms from other Third World countries reduced the value of Korean firms in the process of economic development. The loss of these resource leverages, even though they existed only in a meager form, led to negative bargaining outcomes for the Koreans.

Excessive dependence on Saudi Arabia was another important factor responsible for these developments. Korea diversified into the Saudi market in order to reduce its heavy dependence on US and Japan, its two major trading partners. Such a strategic move pushed Korea into another dependence trap, limiting its maneuverability. Korea now imports almost 60% of its oil from the Kingdom. And over 70% of overseas contracting market is concentrated in the Saudi market. Certainly, this classic form of dependence weakened Korea's power in bargaining with Saudi Arabia.

Finally, negative bargaining outcomes were associated with the overall negotiation style deployed by both countries. While Korea was highly centralized in its decision-making and bargaining styles, Saudi Arabia was decentralized and compartmentalized. This difference in decision-making styles made Korea even more vulnerable. While the Saudi Arabian negotiating party could easily evade any unfavorable outcome by ascribing liabilities or burdens to the non-present agencies or those private sectors, Korea couldn't.

In Chapter Six, we have tried to illustrate that the volume and direction of the Saudi-Korean connection which

matured because of private entrepreneurial dynamism was also affected by the nature of those state strategies pursued. When a complementarity of state interests existed, bilateral transactions reached a high level. When this complementarity faded over time, the level of bilateral ties dropped significantly. More effective state bargaining could have avoided such deterioration, but the presence of a salient power asymmetry in the middle of fading complementarity made the outcome unavoidable, confirming our earlier assertion that "the outcome of inter-South bilateral flows is largely a function of the level of complementarity in entrepreneurial functions pursued by the state."

### FOOTNOTE

1. For details, refer to the Saudi Arabian Tender Law decreed in 1977 (Nasr 1980).
2. The usual rates for bonds are: performance bond (5-10 % of bid value), bid bond (1-5%), maintenance bond (5-10%), and advance payment bond (equivalent of advance payment). Refer to H. Kim (1982: 57-58).
3. Suppose an overseas contractor wins a \$100 million project. The amount of payment guarantee to be covered by the bank(s) is \$20 million, which equals almost one fifth of the bank(s)' capital. Korean commercial banks' capital is usually around \$100 million.
4. For example, Hyundai almost had to cancel its Jubail industrial port contract because of this double counter-guarantee provision. With the helps of the Korea Exchange Bank and a Saudi local bank, however, it could come up with \$279 million syndicate credit from 37 international banks and saved the contract (H. Kim 1982: 59)
5. This relatively easy control by the government was possible mainly because the government was the major shareholder of these commercial banks. For government control of finance in Korea, consult Haggard and Moon (1983).
6. The statutory limit on banks' payment guarantees changed over time. The limit decreased to 500% in 1980 and 100% in 1982 ( Korean EXIM Bank 1980; OCAK 1982; H. Kim 1982).
7. For an overall review of the export financing support scheme, refer to OCAK (1978).
8. Allowing local foreign exchange loans for Korean contractors was a very unusual measure given the Korean government's extremely strict control of foreign exchange.
9. For an excellent overview of the nature of state intervention in Korea, consult Jones and Sakong (1980).
10. S. Lee (1981 and 1982), OCAK (1982) and H. Kim ( 1982:39) offer a thorough review of the contents of these amendments and rationales behind them.
11. The escalation clause refers to a provision in the contract which specifies the linkage between project costs

and inflationary rates. This clause is usually inserted in the contract documents to protect the possible losses of contractors as a result of cost escalation associated with inflation in client countries. Since Saudi Arabia was plagued by high inflationary pressures, foreign firms were very attentive to whether this clause was available or not.

12. This requirement was politically motivated. Since Hyundai, the largest business conglomerate in Korea, had been hesistant to go public, the Korean government inserted this provision so as to force Hyundai and some other firms to open their stocks to the public.

13. This was very strictly enforced. The author came across a number of Korean firms which were banned from business opportunities in the Kingdom by failing to comply with this provision.

14. By 1982, OCAK assumed many of the Construction Ministry's roles and authorities. Among them, the mediating role over competition between Korean firms was also transferred to the Association (S. Lee 1982).

15. It was not only Korean labor law which facilitated Korean firms' labor management. The Saudi labor law, which strictly prohibits labor union activities, helped the Korean government and firms to control workers easily. For the codes of Saudi labor law, consult Nasr (1980).

16. This standardized wage system was introduced after the Jubail labor riot in 1977. The Jubail incident was triggered by wage differentials between Hyundai and another Korean firm, Dongah. The latter based on incentive wage system was paying more than the former on basic salary system. Interview with I.L. Cho, former labor attache at the Korean Embassy, Jeddah. (Feb. 18, 1983, Seoul).

17. The Korean government depicted here casts an image of a "strong state" formulated by Krasner(1978) and Katzenstein (1977). An interesting theoretical point is, however, that state strength should be further differentiated. Certainly, the provision of incentives or disincentives is a function of state capability. However, offering such provisions within the market parameters as in OECD countries is relatively easier than coordinating and controlling the private sector by violating market principles. In this sense, it can be argued that the Korean state is much stronger than those of other OECD countries.

18. Except for first residential ambassador, the subsequent ambassadors were former cabinet members: 2nd ambassador Yoo was ex-transportation minister, 3rd ambassador Chang ex-commerce, construction and energy minister, and current ambassador Choi ex-post and telecommunication minister.

19. Saudi sensitivity to Korean political instability was so great that one Saudi businessman told the author: "During that period, the first thing I did every morning was to check the International Herald Tribune to see if there was any new development in Korea." ( Abdullah Alrajehi, Riyadh, Jan. 26, 1982). Since the Saudi newsmedia did not fully cover the events in Korea, most Saudis relied on the International Herald Tribune.

20. The successful cases include inter-ministrial cooperation between Health-Social Affairs and Interior Ministries.

21. According to D.J. Chang, then Vice Minister for the Economic Planning Board who was also in charge of Inter-Ministerial Steering Committee for the Middle Eastern Affairs, the Korean government set up an emergency task force team and operated it round the clock to monitor the events. He recollected the Jubail incident was one of the most serious crises since Korea's entry into the Middle East market. (Interview, Jan. 25, 1983 Seoul)

22. This information was obtained through interviews with Korean officials in Jeddah.

23. This was particularly true because Saudi partners tended to judge the capability of Korean firms by their connection with the Korean government.

24. From interviews with Haji Sabri J.G. Suh, former President of the Korea Muslim Federation, who led the Korean Muslim delegation. ( March 12, 1982 and Jan. 12, 1982, Seoul).

25. The Korean government's pledge to contribute the landsite was inserted in the Joint-Communique with King Khaled on the occasion of president Choi's visit to the Kingdom.

26. The Korean Embassy offered administrative support and partial financial aid in setting up an Islamic education center for Koreans in Jeddah.

27. This solicitation was a result of ignorance. The Korean government officials equated the World Muslim League with the Vatican. The League is totally different from the Vatican in the sense that the former is one of many international Islamic organizations.

28. Perhaps this was the most rewarding aspect. Sejoo Moon, former information attache at the Korean Embassy in Jeddah recalled that " Islam was the most effective means of penetrating the Saudi media. All the major Saudi newspapers such as Okaz, al-Medina, al-Riyadh, and al-Jazirah have dealt with special issues on Islam in Korea at

least one or more times. However, these newspaper barely dealt with other general aspects of Korean society." (Interview, Feb. 18 1982, Seoul).

29. Dr. Abdullah Nasif, former Rector of the King Abdulaziz University and presently Secretary General of the World Muslim League, and Sheikh Hassan Kutbi, former Minsiter of Haji and Endowment, can be cited as such celebrities.

30. During the second oil shock, the Commerce and Energy Ministries requested the Korea Muslim Federation to solicit special oil concessions from the Saudi government. Thus, the Federation sent telegrams to the Crown Prince, Sheikh Yamani, Sheikh Ali al Harakan, Secretary General of the RABITA, and Prince Naif, which sought their special favors and influence in granting oil concessions to the Korean government. All the Saudi leaders, including Crown Prince Fahd, who received telegrams, responded favorably, and coincidentally the Saudi government made oil concessions both on G-G and D-D bases (Interview with officials of the Korea Muslim Federation, Feb. 18, 1982, Seoul).

31. For details, refer to Chapter Three.

32. The concluding part of this chapter deals with the discussion of these negative outcomes.

33. The deposit period was three months for incoming advance payments (Maeil Gyeongje Sin Mun, June 22, 1979).

34. For a general discussion of negative impacts of the overseas construction industry, refer to S. Park (1978 :11-27) and OCAK (1978).

35. This measure had been amended several times. For the overview of this topic, refer to H. Kim (1982:85).

36. According to the author's interview, Korean contractors conceded that profit margins drastically dropped from a 20% to below 10% in 1982.

37. About \$1 billion was implicated in this scandal. The scandal was politicized not only because of the hugh amount of money involved but also because of the way money has been circulated. Chang, the heroine of this scandal, borrowed such huge sums of money from commercial banks using her political connections ( she was a sister-in-law of President Chun's wife's uncle) and lent them to money seekers in the curb money market. Surprisingly, the majority of borrowers turned out to be overseas contractors since commercial banks tightened credit lending as a part of anti-inflationary measures.

38. By then, liberalization of the banking sector was already set in motion as a part of the stabilization policy

package followed by a severe economic recession in 1980. However, the scandal expedited the process.

39. Originally, the chairman of the committee was Deputy Governor of the Bank of Korea, but he was replaced by a manager-level official at the BOK (Interview with D. K. Lee, Feb. 18, 1983, Seoul).

40. According to the author's survey, there have been a total of 24 cases from 1977 to 1982. The year 1982 showed the highest frequency of labor disputes (7 cases). 18 cases of 24 were related to wage issues.

41. Cement is a perfect example for this (Maeil Geognje Sin Mun, Oct. 26, 1979).

42. By the private sector we mean the OCAK. Refer to footnote (14).

43. For an overall review of these decrees and laws, refer to Nasr (1980).

44. Some of these incentives are described in Chapter Four and Five too.

45. Sharia (Islamic Law) prohibits charging interest.

46. Refer to Chapter Five, particularly the section on non-conventional business practices.

47. The Saudis' confidence in Koreans' ability to bargain may have to do with ethnicity. According to the author's survey, there was a strong sense of Saudi superiority over Asians in the Kingdom.

48. Prince Abdullah's dislike of American firms explicitly surfaced through a feud between him and Vinnel. In the mid-1970s, the American firm undertook major consulting work on the restructuring of personnel and weapon systems of the National Guard. However, Prince Abdullah disapproved of Vinnel's work and the restructuring as done by non-American firms. For this topic, refer to Abir (1983).

49. This was confirmed through interviews with Korean firms which participated in such projects in the northern part of the Kingdom.

50. It is widely believed that Saudi Arabia was particularly instrumental in promoting the Korea's tie with Iraq.

51. There are many different ways of measuring political power rank in the Kingdom. No one would disagree with the following rating of Saudi political figures: King Fahd, Crown Prince Abdullah, Defense Minister Prince Sultan, and

Prince Naif in that order. Thus, Naif is the fourth most powerful political figure in the Kingdom. It is said that above four and Prince Saud (foreign minister) and Prince Turki (director of general intelligence) constitute the Supreme Consultative Council, the highest decision-making body in the Kingdom.

52. Some Western observers conjectured that the arrangement of security cooperation with Korea made through Naif's visit to Korea represents high intensity cooperation (Salomeh 1980). But it was known that the contents of the cooperation involved Korean support for police force training. In addition, Prince Naif's proposal to establish an Islamic College in Korea was strongly opposed by various cabinet members, particularly, finance minister Aba al-Khail. (Interview with authoritative source who wished to remain unknown)

53. Economic self-reliance a la Saudi Arabia does not refer to the type of economic strategy which abandons market (e.g., Tanzania, North Korea, and China under Mao). Instead, it implies a realignment of the national economy in such a way to protect local interests and to reduce excessive dependence on the foreign sector.

54. The Saudi government introduced a classification system of both local and foreign contractors in order to enhance the performance of contractors. According to this system, Saudi local firms have been categorized in the following manner: 1st class (over SR 200 million per year) 24 firms; 2nd class (up to SR 200 million per year) 64 firms; 3rd class (up to SR 50 million per year); 4th class (up to SR 5 million) 130 firms (Source: Office of the Construction Attache, Korean Embassy, Jeddah).

55. In fact, Korean firms maintained their competitive edge mainly because of the availability of construction equipment accumulated through previous contract works. On the other hand, despite the government's preferential treatment, Saudi firms had to purchase the equipment, lowering their competitiveness.

56. Sheikh Omar Kamil, president of the Dallah-AVCO which is one of the largest maintenance companies in the Kingdom, expressed such a grievance to this author (Interview, March 18, 1983, Jeddah).

57. Interviews were conducted both in Jeddah and Riyadh in Jan. 1982 and March 1983.

58. The "Buy Korean" policy was strictly applied among Koreans in the Kingdom. The Korean government promoted even the sales of Korean cigarettes, which is a government monopoly item.

59. For this, refer to administrative circular, no. 17/7942 dated 3/5/ 1398 H, by the Ministry of Finance and National Economy.

60. The newly emerging collective power of Saudi businessmen was demonstrated in the Saudi's first mammoth conference held in Dammam, March 1983. More than 1,500 businessmen attended the conference and sought the ways and means to improve the government-business relationship in the changing phase of economic development. For this, refer to Orakazai (1983:16-19) and Saudi Gazette ( March 14, 1983).

61. Increasing Christian religious activities in Korean work camps were a new dilemma to the Korean government. The Korean government could not endorse such activities, nor could it ban them.

62. This sentiment was shared with intellectuals too. Dr. Alawi abu al-Saud and Dr. Ahmad Ghofali, both American, educated professors of the King Abdulaziz University, expressed a similar opinion on the role of Korean firms in the Kingdom (Interview, March 11 1983, Jeddah).

63. Al-Nuwaiser has been the most controversial figure in the Saudi-Korean relationship. Korean government officials and firms accused him of purposefully undermining the friendly relationship between the two countries by creating various barriers to Korean firms' entry in the Kingdom. Even MEED reported Koreans' uncomfortable relationship with him in the following manner: " Inconsistencies between the policies of Riyadh's Labor and Social Affairs Ministry and the Saudi diplomatic posts abroad are holding up applications for bloc visa to import workers to the Kingdom." (MEED, Nov. 20, 1981:22)

64. From an interview with authoritative source.

65. This feeling was shared by both Korean diplomats in the Kingdom and Saudi officials.

66. The prevalence and persistence of political and social instabilities made President Choi and his close associates reluctant to pursue the state visit plan as scheduled. In fact, the notorious Kwangju incident took place while he was on this trip.

67. King Fahd's plan to visit Japan and US was later cancelled due to the Lebanese crisis.

68. Chi-Song Yoo, president of the Democratic Korean Party, the largest opposition party, visited the Kingdom. It was said that al-Nuwaiser was instrumental in realizing this visit. However, the Saudi government seldom invites opposition political leaders from friendly countries.

69. The Al Kharji project is a US\$ 1 billion massive public housing complex project in the outskirts of Riyadh for which five Korean firms formed a consortium and won the contract. There have been competing claims over this project. While the Housing Ministry, the client of the project, accused Korean firms of delays, misperformances, and misspecifications, Korean firms counter-attacked the client. According to the Korean firms, the Housing Ministry was intentionally creating difficulties for Korean firms and refused to approve the final completion of the project mainly because there were no applicants who wanted to settle in the housing complex. The lack of applicants was alleged to be the result of over-supply of housing facilities as well as an incompleting infrastructure system such as sewage. Thus, Korean firms argued that the Saudi housing authority refused to take over the project in order to defray maintenance costs. The case is still pending in a commercial arbitration court (source: interview).

70. Interviews with Lukman Harun of Indonesia, Dr. Azizur Rahman of the Islamic Development Bank, and Ambassador Ibrahim of the Organization of Islamic Conference.

71. The role of consultants in the Saudi contracting market is a very interesting topic. Most engineering consultants and supervisors in the Kingdom have been either Americans or Europeans. Intentionally or unintentionally, they prefer the selection of materials and equipment (specification) from their home countries. Thus, their role has been an obstacle for both Korean local firms which would prefer relatively cheap materials and equipment in order to be competitive. In addition, since they participate in the initial planning or feasibility stages, these consultants usually have easy access to contract information, which in turn benefits their national contractors.

72. This was particularly so because some Saudi officials have been implicated in bribery scandals with Korean firms.

73. For the financial aspect of Saudi-ization, refer to MEED (October 1981 Special Issue:18-50).

74. For a general discussion of this typology, consult Yoffie(1981, 1982, 1983).

75. The leaking of the government policies to Saudi agents was a very controversial issue. For this, refer to Ambassador Yoo's public accusation of Korean contractors (Y. Yoo 1978).

76. Dong-whie Kim, then Vice Minister of Foreign Affairs who was also Korean ambassador to Iran, strongly opposed Korea's explicit policy shift to Iraq. He believed in the

possibility of equi-distant diplomacy between Iraq and Iran despite Saudi Arabian and US oppositions. (Interview, August 12, 1980, Seoul) In 1983, Kim was killed in Rangoon, Burma, while he was accompanying president Chun as Commerce Minister.

77. For this, refer to the section on Korea's personal diplomacy in this chapter.

78. Information on this was obtained from an authoritative source involved in this bargaining process, who wished to be anonymous.

79. Interview with a Korean diplomat posted in Jeddah. This was confirmed with an official at the Saudi Foreign Ministry. Both wanted to remain anonymous.

80. Along with this diplomat who wished to remain anonymous, S. S. Chang, then Minister to Korean Embassy in Jeddah and now Ambassador to Barbados, conceded to the author that there are not any discernable pro-Korean elites who would help Korean issues explicitly. (Interview, March 24, 1983, Jeddah)

81. This was related to America's role in the Middle Eastern politics. For example, during the AWACS sales debate in the US Congress, the Saudi delegation to the Saudi-US Joint Economic Commission acted more as a political lobby than an economic delegation. In addition, a sharp contrast exists between the Saudi-Korea and the Saudi-US Joint Commission. From the beginning, the latter was backed up by hard cash of \$120 million under the name of trust fund deposited with the US Treasury. It was not the case with Korea. While the Saudi delegation to the Saudi-Korean committee was led by Sheikh Abdullah Ali Reza, deputy foreign minister in charge of economic and cultural affairs, and a number of middle-level bureaucrats, the Saudi-US committee was led by the powerful finance minister, Aba al-Khail, and a number of ministers and deputies. For this, refer to MEED (Dec. 31, 1977) and Saudi - US Joint Commission (annual reports).

82. For this definition of power, consult Baldwin (1979, 1980), Sprout and Sprout (1966), Christensen (1977), Knorr (1977), and Hart (1976).

## CHAPTER SEVEN

### CONCLUSION: THEORETICAL AND PRACTICAL IMPLICATIONS

This study began with some questions about the gaps between theory and practice in the international political economy with special reference to the Third World. If the international economic system had been biased against the South and had the logical counter-strategy by developing countries been a collective action, as argued by a number of scholars in the field, inter-South economic cooperation should have flourished under the multilateral arrangement of rules and procedures. Our data in Chapter One, however, negate such a conclusion. Through the 1960s and 1970s, developing countries had been inclined to seek bilateral ties, rather than relying on multilateral schemes such as regional economic integration and the recommendations of the New International Economic Order. Why this disparity between rhetoric and reality? Why and how have these bilateral inter-South transactions become more pervasive? What have been the outcomes of such interaction in the South? This study has explored these questions through a study of Saudi Arabian-Korean bilateral relations over the last decade. The case study conducted here reveals a number of interesting theoretical and practical implications

related to the behavior Third World developing countries within the larger framework of the international political economy.

### Theoretical Implications

Perhaps the greatest value of this study is that it opens up a new direction for the study of political economic behavior in the Third World. Up to the present, few have paid any serious attention to bilateral economic transactions between developing countries. Either because of preoccupation with dependencia rhetoric or due to the influence of the liberal "myth" of regional integration and interdependence, bilateral economic relations between developing countries have been treated as trivial or residual. This study argues that inter-South bilateralism has and must have its own ontological place in the discipline of international political economy.

The findings in Chapters One and Three support such an argument. Chapter One illustrates that while intra-South economic transactions based on multilateral economic arrangements such as regional integration schemes have decreased over the last two decades, inter-South bilateral ties across the different regions of the South have substantially increased during this period. Of particular interest is that such bilateral ties have grown despite the apparent lack of incentives such as customs unions or geographic proximity. Our observations in

Chapter Three further strengthens this argument by offering evidence on the micro-level. Although Korea and Saudi Arabia have neither enjoyed favorable background conditions (e.g., distance, cultural and political proximity, and colonial ties), nor shared explicit multilateral arrangements, their economic cooperation has proven to be impressive in both relative and absolute terms. Another fascinating empirical aspect of the Saudi-Korean connection is that an inter-South bilateral tie could surpass a North-South bilateral arrangement in terms of amount and volume. The case in point is the Saudi construction market. The market had been overwhelmed by a handful of OECD countries, which created a classical form of dependence-dominance relationship between Saudi Arabia and those countries. However, the formation of the Saudi-Korean connection reversed such a bilateral pattern and relieved the Kingdom of a set of costs and constraints emanating from previously dependent bilateral transactions.

The following implications can be drawn from this phenomenon: 1) The Third World bilateralism deserves our due theoretical as well as empirical attention. Treating it as residual or peripheral is to commit a fallacy of "misplaced concreteness" in the words of Whitehead; 2) In order to capture this evolving phenomenon properly, one must disaggregate developing countries and analyze their dyadic interactions on their own terms, not in relation to their structural position in the international economic

system; 3) The pre-occupation with intra-South collective actions on the assumption of the Southern unity and homogeneity is thus tantamount to a distortion of reality whose features are characterized by anarchic and entropic behavior.

Another major implication drawn from this study is the importance of the state in understanding political economic behavior of the developing countries. Chapters Four and Six show that the rise and decline of the Korea and Saudi Arabia bilateral connection were less a function of a changing pattern of comparative advantage or of their respective structural position in the international economic system per se than a result of strategies pursued by both governments. Of course, comparative advantage, industrial complementarity, and constraints and opportunities emerging from the system have proved to be important in affecting the volume and direction of the bilateral tie. But they served merely as pre-conditions, not as the ultimate determinants. The key factor responsible for the formation and culmination of bilateral ties between the two countries was a set of state policies that evolved out of strategic calculation of changing environments (i.e., market, systemic constraints and opportunities) in lieu of state objectives (i.e., inter-South diversification in a bilateral form).

This finding appears to pose a serious challenge to theoretical assertions commonly shared in the field that the state in developing countries has become obsolete

conceding its power to market forces, or trapped helplessly in a dependent relationship with the capitalist system. While Saudi Arabia has a rentier economy, Korea has a dependent one. Yet, state authorities in these countries not only dominated the private sector by shaping and re-shaping market parameters as well as by modifying its behavior on the micro-level, but also sought a set of strategies to reduce dependence and to gain more autonomy from the international economic system. Our discussion in Chapter Six indicates that state authorities in both countries have been more than mere mediators of competing private interests. They were not only free from specific socio-political pressures, but also interventionist in such a way that they facilitated, coordinated, and controlled private interests within the overall framework of their goals and objectives.

The implications deduced from this finding include: 1) the state must be restored as a primary unit of analysis in understanding the political economic behavior of developing countries; 2) we must focus on specific state policies, legislation, and performance, rather than on reified structural parameters (or templates) allegedly emanating from the international economic system or on static variables associated with market functioning; 3) we must give more attention to dynamic interplay of state objectives, decision making structures, domestic political power interactions, and the changing environmental impetus.

Third, this study explored the role of private entrepreneurs in the Third World as an important unit of investigation. Traditionally, private entrepreneurs in the developing countries have been regarded as backward, non-innovative, and dependent. Their image has been chiefly associated with comprador class and passive recipients of capital and technology from the core capitalist countries through multinational corporations. The discussion in Chapter Five, however, refutes this characterization. In particular, Korean firms have been competitive and aggressive risk-takers, successfully outpacing firms from the core countries. Though limited by the parameters set by the state, entrepreneurial dynamism exercised by Korean firms turned out to be a crucial element in shaping the direction and volume of bilateral transactions between Korea and Saudi Arabia. Furthermore, the formation of inter-South horizontal business connections has opened up a new area of theoretical and empirical investigation. Businessmen in the developing countries appear to be interested in forging horizontal links of private interests as opposed to vertical links (i.e., North-South) which have been previously the dominant pattern of interest articulation between the domestic and external private sectors. The formation of this horizontal linkage has largely been in line with state preferences shaped by the domestic political structure in general and the state-business relationships in particular. This observation suggests that there should be theoretical and

empirical attention paid to private entrepreneurs in the study of foreign economic policy or political economy of development of Third World countries. And this attention should be paid in connection with the private sector's relationship with state authorities as well as with the overall political structure of the country under study.

Finally, this study suggests that development strategy can be a useful starting point in analyzing political the economic behaviour of the developing countries. Previous studies in the fields of international political economy and Third World development have treated development strategy chiefly as a dependent variable or policy outcome to be explained either by the pattern of domestic political interactions or by the type of incorporation in the international division of labor. Observations in Chapters Four and Six, however, illustrate that development strategy can be a powerful independent variable to explain and/or predict internal and external economic policy behavior as well as changes in domestic political power configuration.

As a matter of fact, the initiation of a certain development strategy is a function of the distribution of political power among major social forces and of the pattern of external links at the time of its inception. Nevertheless, once such strategy is initiated as a result of strategic choice made by the state, it develops its own logic affecting the domestic political arena and external

links. As seen in Chapter Four, the Korean strategy, founded on export promotion, entailed a variety of costs and constraints such as dyadic sensitivity and systemic vulnerability which eventually led to the modification of its external behavior, i.e. inter-South bilateral diversification. A similar explanation can be made in the case of Saudi Arabia where the rate and direction of its development strategy induced its close ties with Korea. Likewise, the rate, direction, and pattern of economic development strategy affect the nature of internal and external constraints and opportunities and consequently the pattern of domestic political interactions, leading to a set of new internal and external policy adjustments. In this sense, development strategy, as a crystallization of state strategies incorporating internal and external constraints and opportunities as well as the resulting domestic political power configuration, can be a useful starting point for investigating political and economic behavior in the developing countries.

In addition, the nature of development strategy and subsequent formulation of development plans become an essential factor explaining the direction and volume of bilateral ties. It is not only because they offer a shopping list on what to buy and sell between a dyadic pair of countries, but also because they reveal crucial information on industrial competitiveness as well as complementarity by determining the level of supply capability and income elasticity of demand between the two

countries.

### Practical Implications

The practical policy implications derived from this study can be narrowed down to three major concerns. As discussed in Chapter One, is the Saudi-Korean connection viable?, and what kind of options are available to sustain such relationship?; Can such Third World bilateralism be successfully emulated by other developing countries?; To what extent is Third World bilateralism beneficial?

As shown in the last section of Chapter Six, the future of the Saudi-Korean connection does not appear promising. Declining industrial complementarity and changing state interests are likely to limit the viability of the bilateral relationship to a great extent. In particular, Saudi-ization is and will be the primary barrier to Korean efforts to continue its economic relationship with Saudi Arabia. In face of this declining relationship, Korea has three possible options: voice, loyalty, or exit (Hirschman 1970). The increase in voice involves the intensification of bargaining, issue-linkage, and other forms of diplomacy to induce the Saudis to be more cooperative with the Koreans. As our findings in Chapter Six suggest, however, this option has very limited applicability. Power asymmetry in favor of Saudi Arabia prevents Korea from effectively pursuing this option. Furthermore, the lack of explicit rules, norms, or procedures governing Saudi-

Korean bilateral relations makes it almost impossible for Koreans to utilize this voice option.

The second plausible option would be the increase in loyalty in such a way that the Koreans adjust to changing Saudi policies as well as related market conditions by making substantial concessions. In choosing and implementing this option, however, there are a number of obstacles. In order to deploy the loyalty option, the Korean government needs to extend enormous facilitative and insulative benefits to Korean firms operating in the Kingdom in terms of financial and administrative incentives. But it is too costly for the Korean government to do so. For example, Korean overseas contractors now owe domestic banks some two trillion won (\$2.7 billion) and foreign banks \$3.4 billion. In addition, most Korean contractors, except 10 to 15 major firms, currently face the serious liquidity problems. The Korean government is not in the position to continue its financial support to these firms, not only because of its current foreign debt standing but also because of a simple economic calculation that Korean firms are no longer competitive enough to survive in the Saudi Arabian market. The latter (declining competitiveness) has been chiefly due to rising wage costs. But the Korean government seems to have shown virtually no interest in controlling wages. As of 1983, Korean labor costs were over twice as high as those of other developing countries. While the former was

approximatley \$1,200, the latter was around \$500 (e.g., \$575 for Indians, \$ 520 for Philipinos and \$355 for Bengalis). It is therefore unlikely that the Korean government will pursue any policy designed to surpress current wage levels in order to ensure Korean firms' survival in the Saudi market.

Apart from domestic barriers, the nature of the Saudi market is drastically changing in such a way to limit the effective deployment of the loyalty option. As discussed in Chapter Six, the continuation of Saudi-ization policy would be the primary obstacle. However, there are another additional factors which would not allow Korea to use the loyalty option. First, the decreasing oil revenue ( from \$108 billion in 1980 to \$ 40 billion in 1983) has substantially reduced the budget allocation for development expenditure in general and the size of the contract market in particular. Table 7-1 illustrates the drastic reduction in the value of new contracts in the Saudi market. The trend is likely to continue given the persistence of global oil glut. Furthermore, a sharp reduction in oil revenue has entailed a variety of disincentives to foreign firms operating in the Saudi market such as delayed pro-rata payments, a sharp drop in advance payments (from 20% to 10%), and tough price bargaining by the Saudi clients (e.g., a further cut of the lowest bid prices through negotiation).

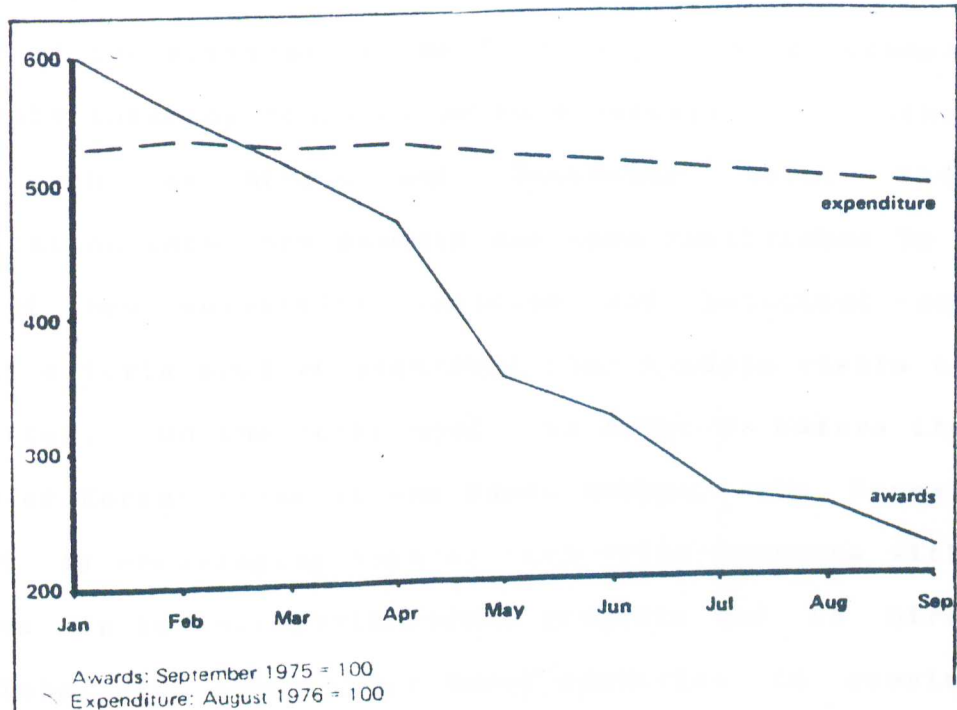
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table 7-1

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Another major factor impeding the Korean adjustment to the Saudi market through the loyalty option is the rapidly changing nature of the Saudi contract market. Up to 1980, this market was characterized by labor intensive contracts originating from the construction of physical and social infrastructure projects such as roads, ports, housing complexes, and schools. Since 1980, however, more technology-intensive projects began to constitute the major portion of the Saudi market with the beginning of the Third Development Plan. While labor-intensive projects have been de-emphasized, more money has been allocated for the construction of light and heavy industrial plants. For example, the Third Plan alone aimed at establishing over 500 manufacturing plants, 34 power generating plants, 16 desalinization plants, 8 cement plants, and many other petroleum related industrial plants. This shifting market has constrained the scope of Korean firms' activities mainly because they are not yet technologically sophisticated enough to bid on these turn-key based industrial plants tenders. Although Korean firms have been successful in obtaining a small share, as shown in Chapter Three, OECD firms with advanced technology have monopolized this newly emerging market. This technological gap

Table 7-1: Declining Saudi Contract Market (Jan.- Sept. 1983)



Source: MEED, Nov. 18, 1983

seriously blocks the Koreans from sustaining their economic relationship with the Kingdom.

Aware of these limits in pursuing both voice and loyalty options, the Korean government is seeking a hybrid of exit and loyalty. While withdrawing its facilitative and insulative roles for private firms engaged in the Saudi market through a set of liberalization policies ( i.e., the principle of the survival of the fittest), the government is actively inducing those firms to diversify into other markets such as Africa and Southeast Asia. This diversification into new markets has been facilitated by a number of new supportive policies and political and diplomatic efforts such as president Chun's state visits to the countries. On the other hand, in order to ensure the viability of Korean firms in the Saudi market, the Korean government is encouraging them to form joint-ventures with OECD firms in technology-intensive projects and to hire cheaper labor from other Third World countries to remain competitive in the labor-intensive contract market.

Given evidence such as growing Korean withdrawal from the Saudi market and their willingness to diversify into other markets, however, the loyalty option( i.e., joint-venture with OECD firms and hiring of the Third World labor) is apparently not working well. In this regard, the exit option appears to be the only option left to both the Korean government and firms, which implies the limited viability of the Saudi-Korean connection.

Despite the fading perspective of the Saudi-Korean connection, a growing number of developing countries have sought to emulate the Korean pattern of market penetration in the Kingdom. While Korean firms were deliberating about a diversification option, countries such as Taiwan, Pakistan, Indonesia, India, and Turkey have been actively pursuing entry into the Saudi market since 1980. The figures in table 7-2 illustrate how aggressive they are.

Table 7-2:  
Late-Comers in the Saudi Contract Market

(unit: US\$ million)

Country	Pre-1980	1980-1982
Taiwan	617	715
Pakistan	260	688
Indonesia	.	291
India	36	229
Turkey	n.a.	6,000 (1)

1) 1981-Jan. 1983

Source: Saudi Business Feb. 26-March 4, 1983: 22,  
Korean Embassy, Jeddah

All these new comers, with the possible exception of Taiwan, have sought for labor-intensive projects by fully utilizing their comparative advantage (i.e., cheap labor). Their governments have also provided extensive political and facilitative support. Among these late comers, Turkey attracts special attention. Until 1980, there were only two Turkish firms doing business in the Kingdom. Within less than three years, however, the number of Turkish

firms increased to over 70 netting \$ 6 billion worth of contracts (Saudi Business Feb.26-March 4, 1983: 20-26).

Meanwhile, the Chinese government has shown its intention to get into the Saudi contract market. After having performed successfully in the North Yemen and Jordanian markets, the Chinese are actively seeking entry into the Saudi market using the mediating roles of overseas Chinese firms based in Hong Kong and Singapore. For that purpose, the Chinese government has invited a number of influential Saudi businessmen to China and has pursued a set of domestic and foreign policies sympathetic to the Saudi government such as their appeasement policy toward Chinese Muslims and the denunciation of the Soviet invasion of Afghanistan ( MEED Oct. 8, 1982: 75-84; Business Week, May 17, 1982). Apart from this contract and manpower market, financial cooperation has increased between Saudi Arabia and a number of Latin American countries such as Brazil ( MEED Sept. 1981:2-27 ; Saddy 1983).

The evidence above cited indicates that the Saudi-Korean connection is not a unique case of Third World bilateralism. An increasing number of developing countries are inclined to engage in bilateral economic transactions as opportunities develop.

Finally, how beneficial is Third World bilateralism? Evidence provided in Chapter Three indicates that it helped to reduce the burden of dependence on the Northern countries and brought about various welfare and macro-

economic benefits. However, it has not been without some cost such as adverse impacts on inflation and employment. Furthermore, as Chapter Six illustrates, Third World bilateralism as seen in the case of the Saudi-Korean connection, involves a classical pattern of dominance-dependence, strategy-counter-strategy, and vulnerability-sensitivity problems. Contrary to our common sense understanding, an inter-South bilateral relationship is characterized more by anarchy than by harmony and solidarity. The pursuit for short-term gains leads to conflict situations where the more powerful prevail over the less powerful. Thus, the dependence-dominance issue is not the exclusive attribute of the North-South relations, but equally applicable to the South-South axis. Broadly speaking, it is endemic to any dyadic interaction. An implication emerging from this phenomenon is that there is a fundamental limit to the deployment of inter-South bilateral diversification as an effective tool to enhance economic gains. This in turn necessitates second thoughts on the desirability of effective regimes (or multilateral arrangements of rules, norms, and procedures) encompassing the developing countries which differ radically from current ones such as NIEO and regional economic integration schemes.

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