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The Saudi Arabian Economy

Policies, Achievements and Challenges

Second Edition



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CHAPTER 3

PUBLIC FINANCE

Overview

- Saudi oil production and revenue have fluctuated erratically over the period 1970-2008.
- Peak oil production periods were 1974-1981 with another recovery during 2002-2008.
- Oil revenue followed the same pattern.
- Government expenditures, and the manner and direction of such expenditures, plays a vital role in Saudi economic development.
- As such, the fate of oil revenue is critical.

TABLE 3.1 Saudi Arabian oil production and oil revenues

	<i>1970 – 1973</i>	<i>1974 – 1981</i>	<i>1982 – 1985</i>	<i>1986 – 1991</i>	<i>1992 – 1996</i>	<i>1997 – 2001</i>	<i>2002 – 2008</i>
Oil Output (million barrels)	8.1	25.874	6.672	12.292	14.778	14.548	22.269
Oil Revenue (SR billion)	69.98	1.3746	540.3	478.3	571.6	742.5	2284.1

Source: SAMA, 2009

- High oil revenues induce a rise in the **Marginal Propensity to Import (MPI)** especially in an open economy such as Saudi Arabia.
- MPI is defined as a change in imports, net of non-oil exports, investments and transfers/change in oil exports.
- As such ,a change in oil export revenues is an important determining factor for MPI.

Table 3.2 Marginal propensity to import (MPI) out of oil revenues: Saudi Arabia 1973 – 2008

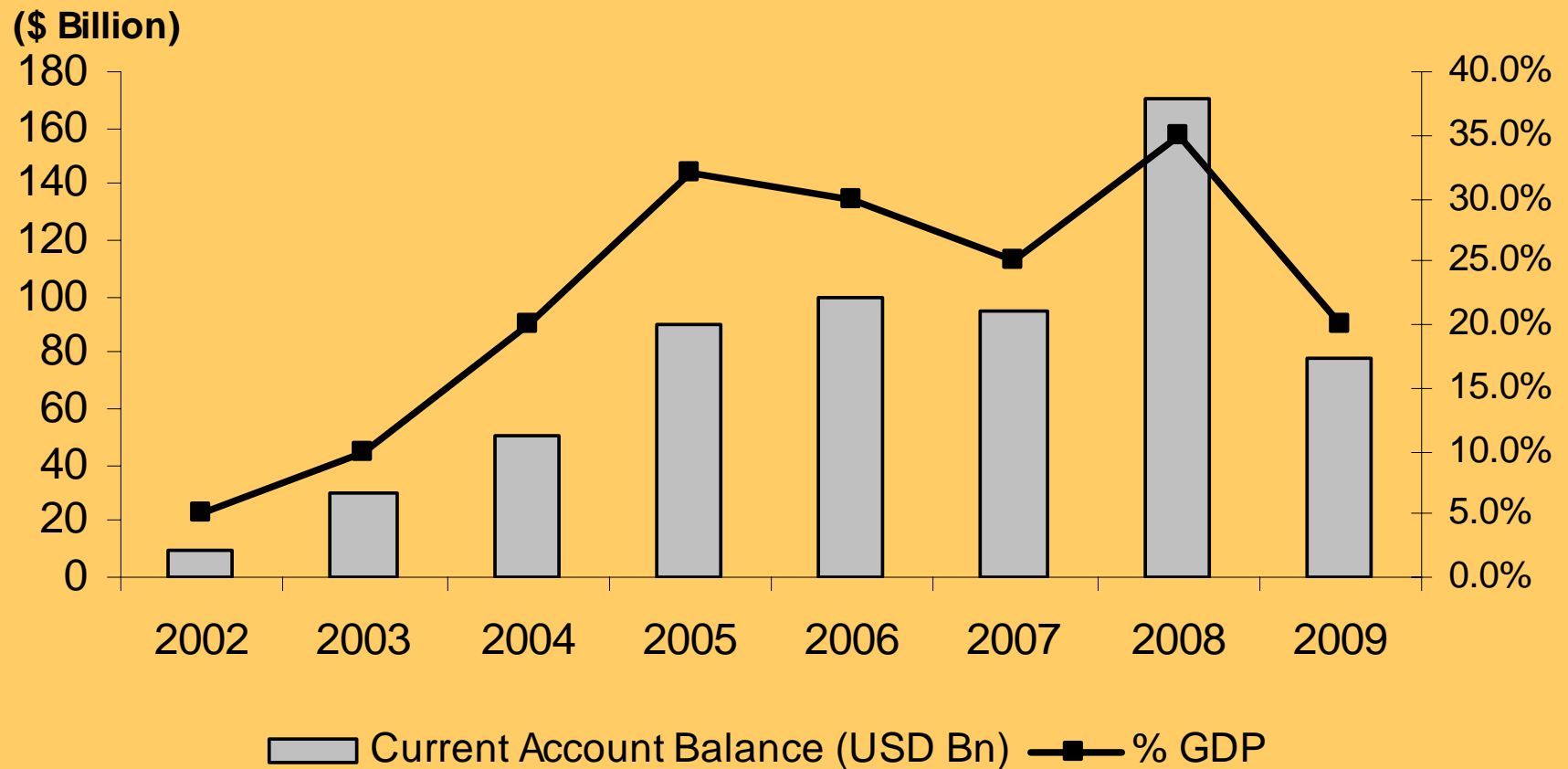
<i>Period</i>	<i>1973 – 1974</i>	<i>1973 – 1975</i>	<i>1978 – 1980</i>	<i>1978 – 1981</i>	<i>2003 – 2005</i>	<i>2005 – 2006</i>	<i>2006 – 2007</i>	<i>2007 – 2008</i>
MPI	0.23	0.45	0.28	0.41	0.21	0.66	1.31	0.47

Source: SAMA, IMF, National Commercial Bank, 2009.

Current account is still positive

- Current account balances began to rise from 2002, to reach around 38% of GDP in 2008.
- Current account surpluses translated to a rise in Saudi official **reserves** managed by SAMA, and constitute a significant fiscal buffer for the Kingdom.

Figure 3.1. Current account balances 2002-2009



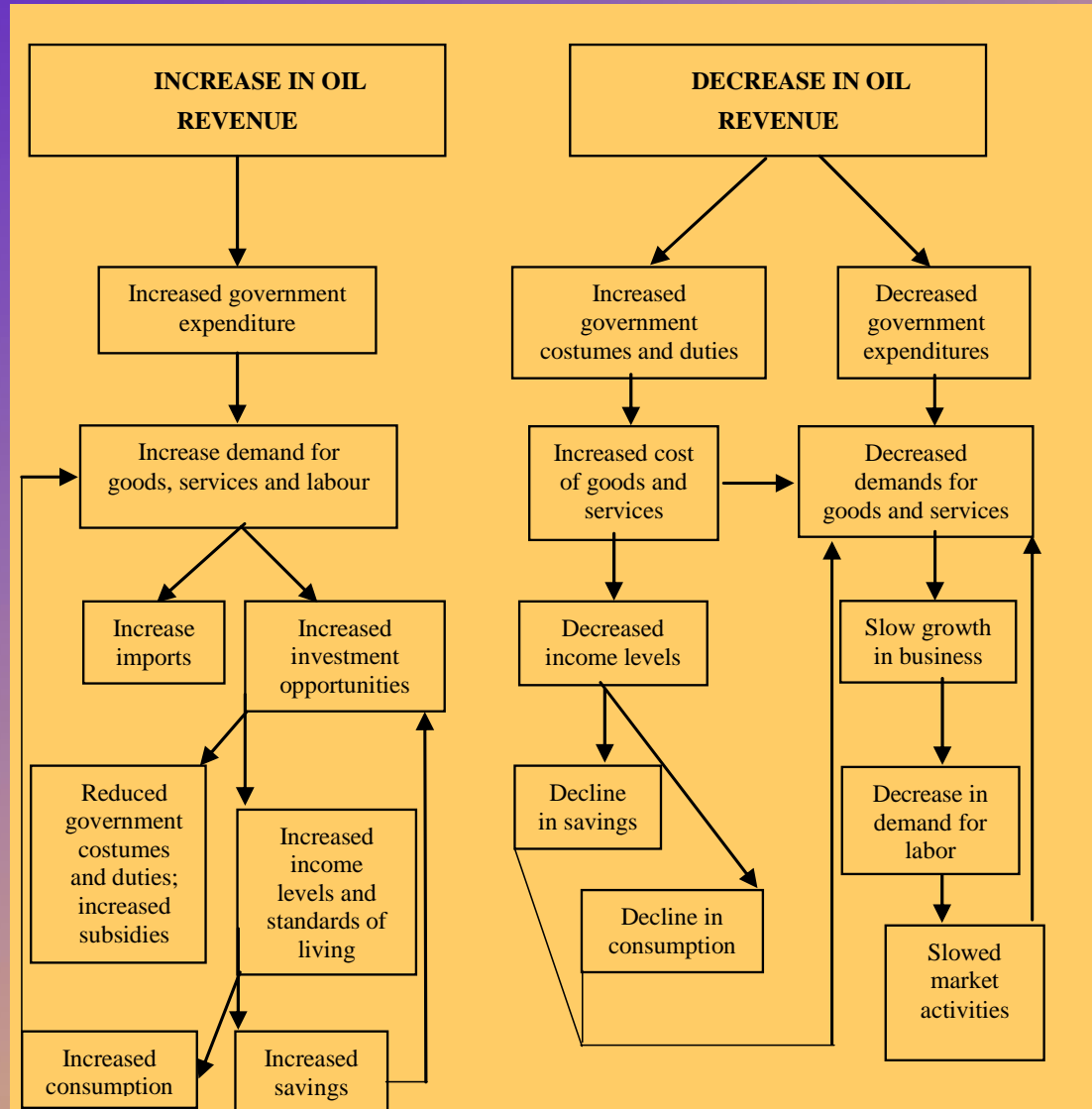
Source: *Ministry of Finance, IIF*

- **Overdependence on oil versus building true wealth:**
 - **Key economic objective is to move away from a state driven economy dependent on oil wealth.**

This is not easy.

- **Dilemma of reliance on oil income and its volatility is illustrated in the following model.**

Figure 3.2. Saudi oil revenue volatility model



Adopted from Cleron, 1978.

The Saudi budgetary system: signals vs. reality

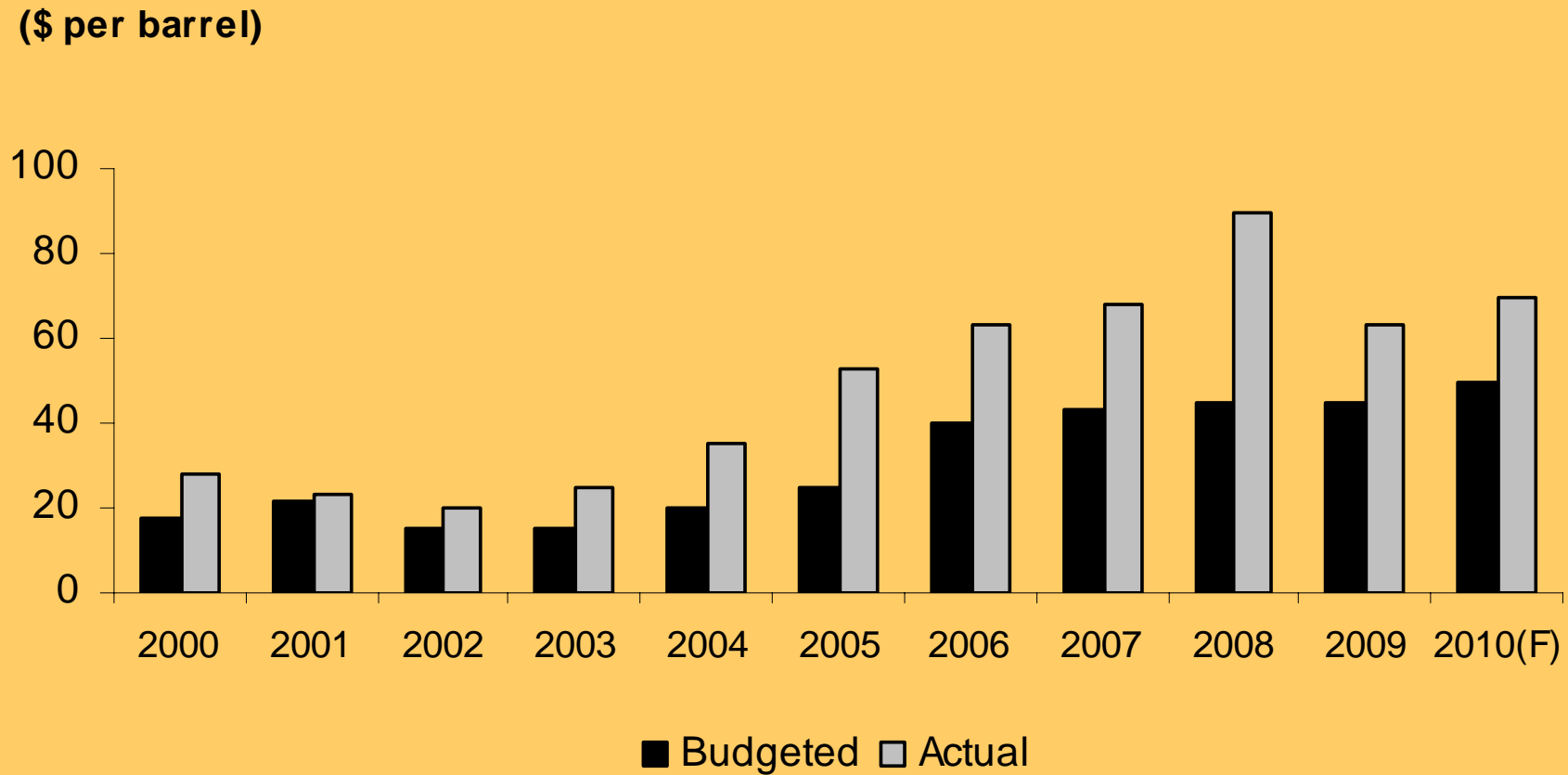
- The budget serves as a “signpost” of government intentions
- However two fundamental core issues are faced.
 - 1) inability to control over a large segment of revenues
 - 2) inability to curb on expenditures, or to remain within budgeted expenditures.
- This has been a consistent pattern since 1981, for *both budgeted* revenues and expenditures, as opposed to *actual* revenues and expenditures.

Table 3.3 Saudi actual vs. budgeted revenues and expenditures comparison 1981 – 2009

<i>Year</i>	<i>Budgeted Revenue</i>	<i>Actual Revenue</i>	<i>Realized Revenue surplus/ deficit</i>	<i>Budgeted expenditure</i>	<i>Actual expenditure</i>	<i>Realized expenditure deficit/ surplus</i>	<i>Overall Budget Def/ Surplus</i>
1981	340	368	+28	298	284.6	+13.4	+83.4
1982	313	246	(67)	313	245	-68.0	+1.0
1987	103	103.8	+0.8	159	173	-14.0	-69.2
1992	151	169.6	+18.6	181	211	-30.0	-41.4
1994	120	129	+9.0	160	163.7	-3.7	-34.7
1996	132	178.8	+46.8	150	198.1	-48.1	-19.3
1997	164	205.5	+41.5	181	221.3	-40.3	-15.8
1998	178	143	(35)	196	189	+7	-46.0
1999	121	147.5	+26.5	165	183.8	-18.8	-36.3
2000	157	248	+91	185	203	-18	+45.0
2001	215	230	+15	215	255	-40	-25.0
2002	157	204	+47	202	225	-23	-21.0
2003	170	295	+125	209	250	-41	+45.0
2004	200	392	+192	230	285	-55	+107
2005	280	564	+284	280	346	-66	+217
2006	390	673	+283	335	393	-58	+280
2007	400	642	+242	380	466	-86	+176
2008	450	1,100	+650	410	520	-110	+580
2009	410	505	+95	475	550	-75	-45.0

Sources: Ministry of Finance, SAMA..

Figure 3.3. Saudi oil revenue volatility model



Source: SAMA, BP, F = Forecast

Budget allocation by sectors reveals

- Human resource expenditure increasing over time
- Health and social development assumes greater spending.
- Defense and security is a significant expenditure item.
- Over recent years, the government's expenditure on subsidies and infrastructure development has also risen.
- **Capital expenditure** began to rise from 2006, reversing previous years declines, as opposed to increases in current expenditure.

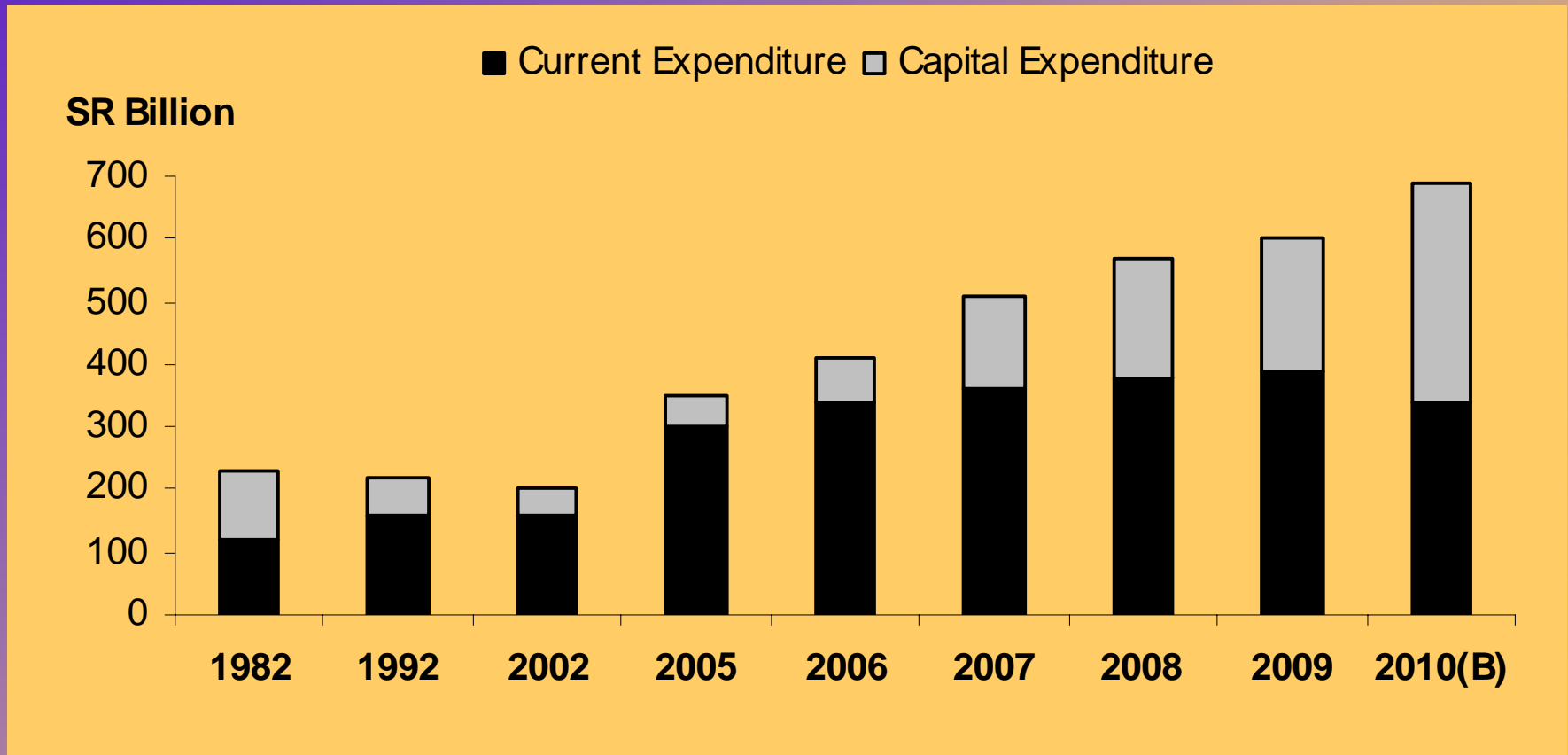
Table 3.4 Saudi Arabia budgeted spending by sectors 1982-2010 (SR million)

	<i>(Million Rls)</i>					
<i>SECTOR</i>	<i>1982</i>	<i>1992</i>	<i>2002</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
A. Revenue						
Oil Revenue	270,579	117,693	97,000	370,000	320,000	405,000 ^(e)
Other Revenues	42,821	33,302	60,000	80,000	90,000	65,000 ^(e)
Total	313,400	151,000	157,000	450,000	410,000	470,000
B. Expenditures:						
Human Resource Development	31,864	31,855	47,037	104,600	121,942	138,000
Transport & Communications	32,535	8,452	5,464	12,143	14,642	24,000
Economic Resource Development	22,045	4,615	4,969	16,317	21,692	31,000 ^(e)
Health & Social Development	17,010	13,534	18,970	34,426	40,426	61,000
Infrastructure Development	11,705	2,090	2,693	6,384	7,762	15,000 ^(e)
Municipal Services	26,244	5,922	7,965	14,954	16,509	22,000
Defence & Security	92,889	57,601	69,382	143,336	154,752	150,400 ^(e)
Public Administration and other Government Spending	44,586	49,176	39,316	63,031	79,148	80,000 ^(e)
Government Lending Institutions	23,382	648	373	479	524	600 ^(e)
Subsidies	11,162	7,107	5,831	14,329	17,602	18,000 ^(e)
Total	313,400	181,000	202,000	410,000	475,000	540,000

Sources: SAMA, 2009 Ministry of Finance 2010.

(e) estimates.

Figure 3.4 Saudi government expenditure: capital and current outlays. Actuals 1982-2009, Budget 2010. (SR Billion)



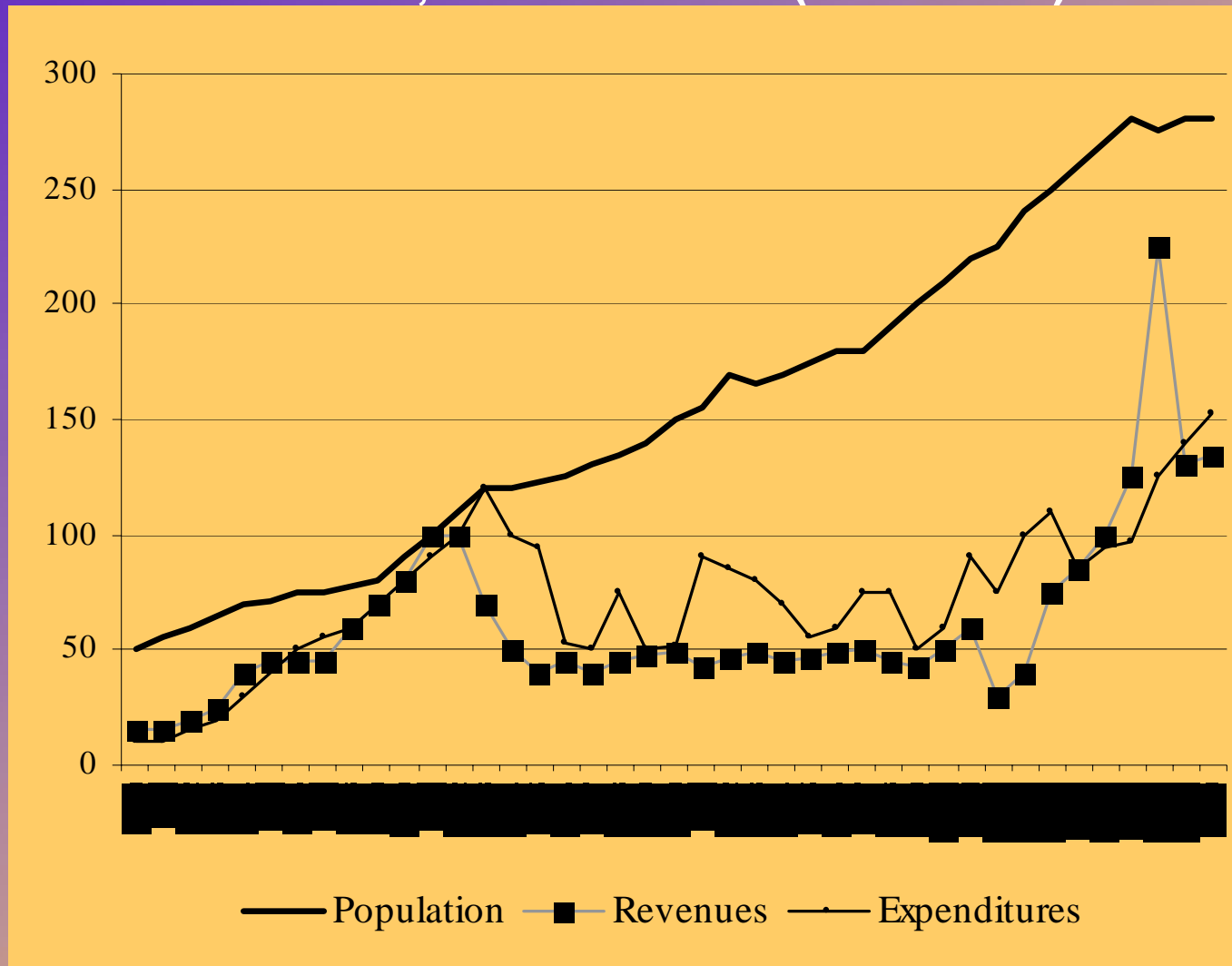
Sources: SAMA, 2009, Ministry of Finance

2010 = Budget

Meeting a growing population's needs

- High population growth rates in Saudi Arabia makes it more urgent to diversify and expand the revenue base.
- Government finances **are not** catching up with population trends, despite some exceptional revenue years such as in 1982 and 2008.

**Figure 3.5 Saudi Arabia population and government finances
1970 – 2009, Forecast 2010. (1980 = 100)**



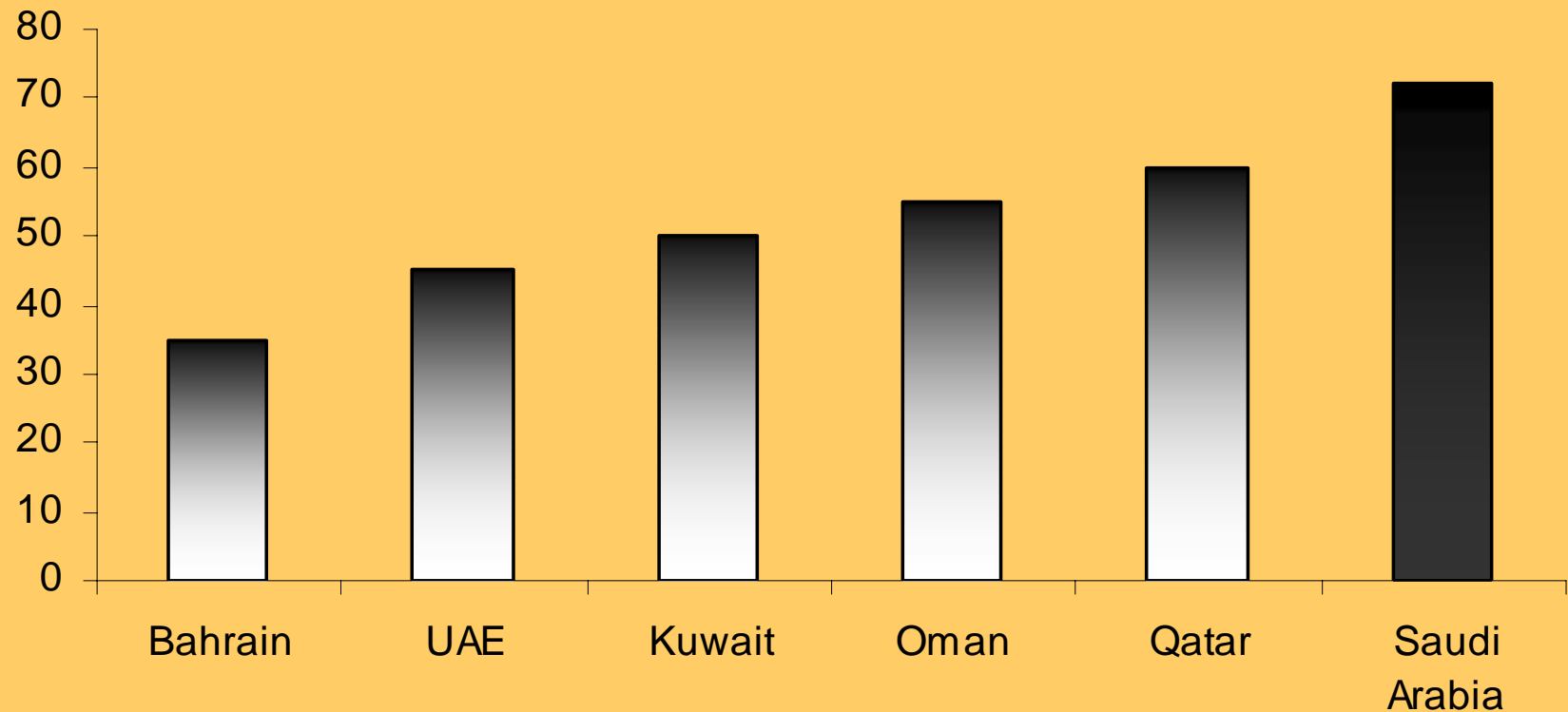
Source: Adapted from SAMBA, 2002.

Note: Population and government finances data rebased to an index with the base year 1980 = 100. Lines represent relative change from the base year.

GCC trends are the same

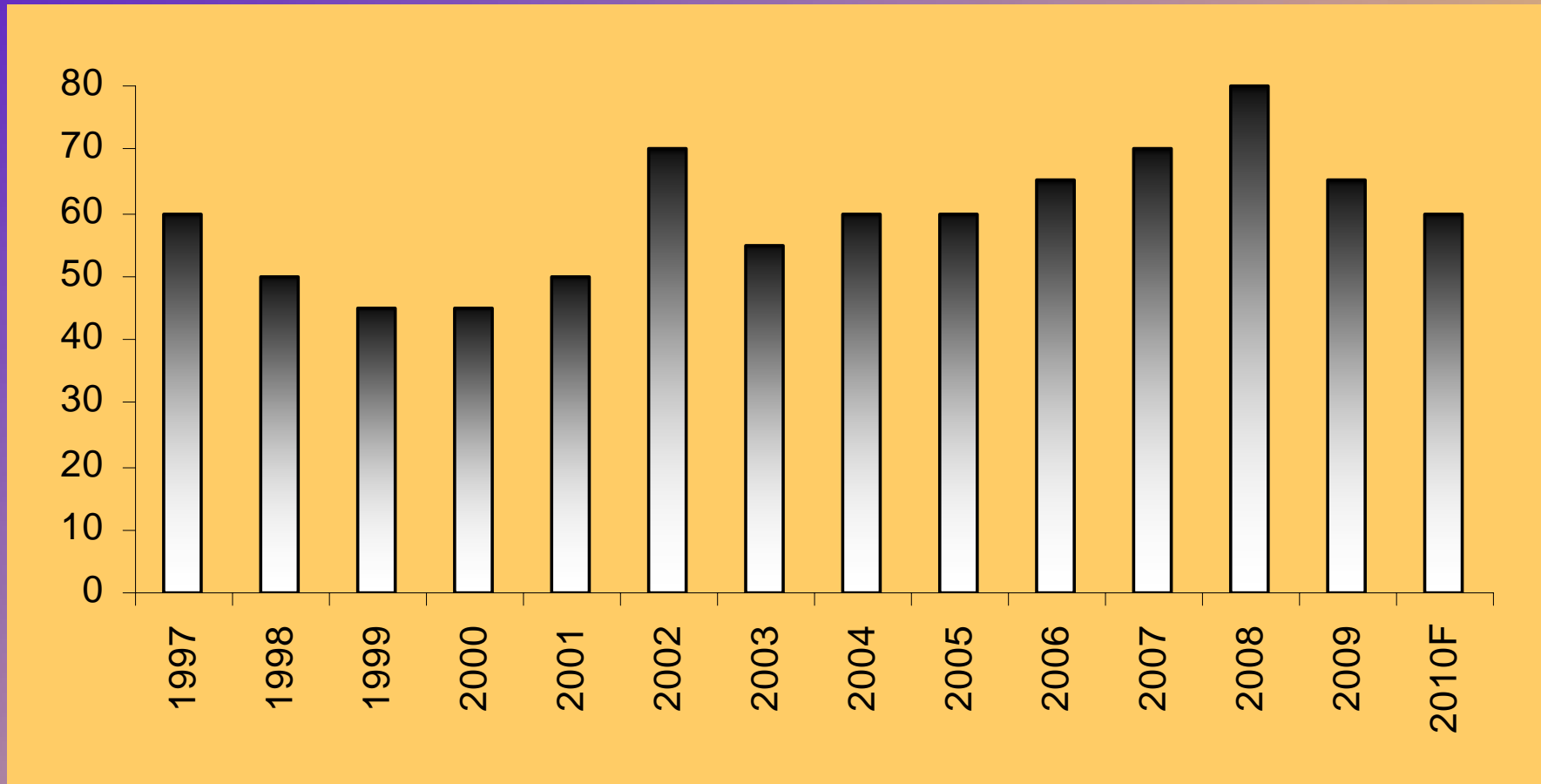
- **Government fiscal expenditures are a prevalent feature of **all GCC countries**.**
- **Even in low oil price and revenue years, the Saudi government spending, as a % of non-oil GDP, averaged around 45% levels.**
- **Saudi fiscal expenditure for 2009 was the highest at nearly 70% of non-oil GDP, compared with 35% for Bahrain and 55% for Qatar.**

Figure 3.6. Regional fiscal stimulus in 2009 (% of non-oil GDP)



Source: SAMA, GCC Central Banks.

Figure 3.7. Saudi fiscal stimulus: Government spending as % of non-oil GDP 1997-2010

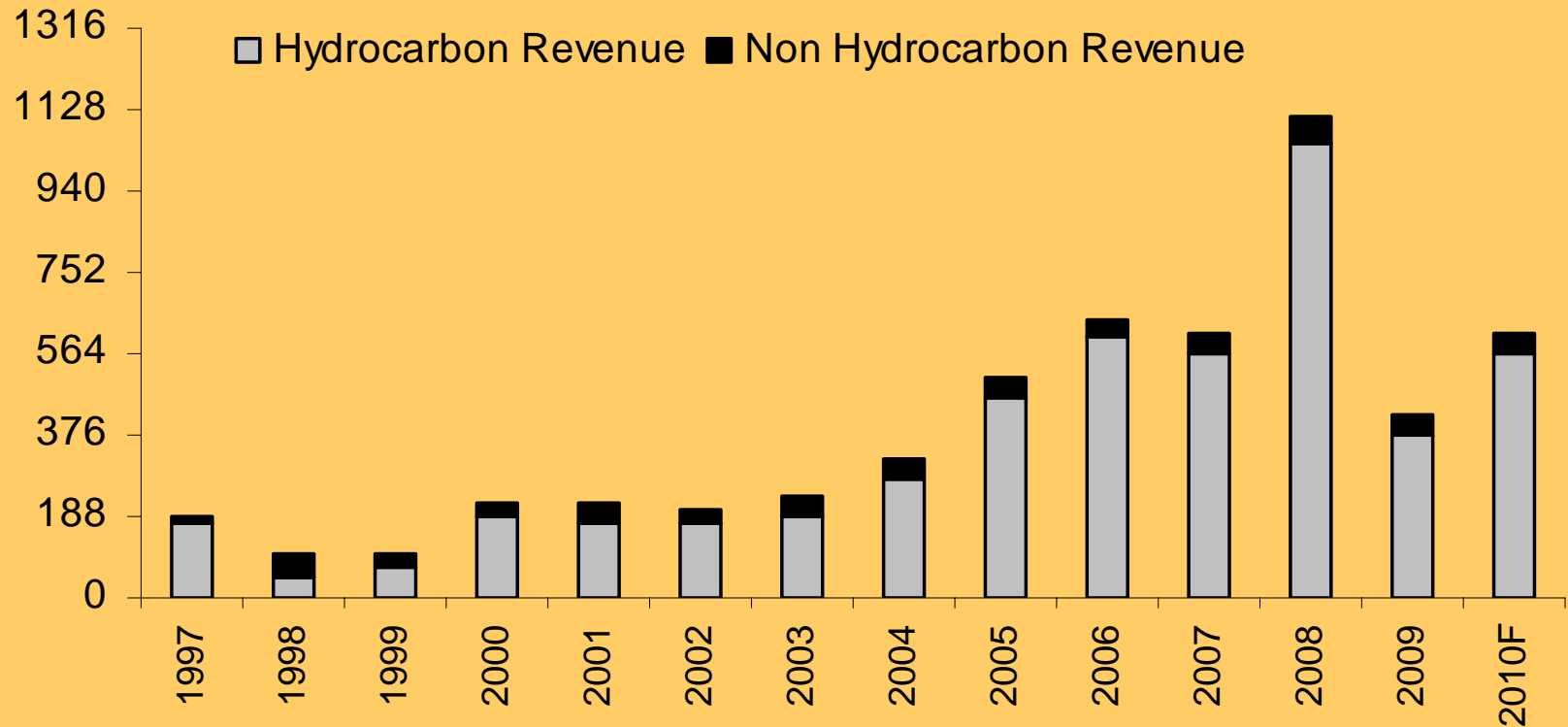


Source: Ministry of Finance, SAMA.

Income diversification is not easy:

- Despite efforts at diversifying the non-oil revenue base, Saudi Arabia's consolidated government revenues is **predominantly hydro-carbon based**.
- Major sources of **non-oil income** comes from:
 - Investment income from Saudi foreign assets
 - Fees and charges
 - Foreign corporation income tax
 - Custom duties
 - Other income, including ***zakat***
- Major sources of **expenditures** include:
 - Wage bill
 - Government supplies and services
 - Interest on the national debt
 - Subsidies and operations and maintenance.

Figure 3.8 Consolidated Saudi Government revenues by sources (SR billions) 1997-2010



Source: SAMA, Ministry of Finance

**Table 3.5 Saudi Arabia budgetary revenues and expenditures:
actual outturns 1994-2009 (SR billions)**

YEAR	1194	1998	2002	2003	2007	2008	2009
(A) Total Revenue	129.0	141.6	213	293	642.8	1,100.9	505
• Oil	95.5	80.0	166	231	562.1	983.3	410 ^(e)
• Non-oil	33.5	61.6	47	62	80.6	117.6	95 ^(e)
Of which Non-Oil:							
- Investment Income	15.1	21.7	13.9	11.1	26.1	39.6	28.0
- Fees + Charges	10.1	21.2	23.0	24.0	26.8	27.0	27.5 ^(e)
- Income Taxes	1.6	2.2	2.4	3.1	5.6 ^(e)	6.8 ^(e)	5.5 ^(e)
- Custom Duties	2.7	4.5	4.0	5.5	6.4 ^(e)	9.7 ^(e)	7.3 ^(e)
- Other (including Zakat)	4.0	12.0	3.7	18.3	15.7 ^(e)	34.5 ^(e)	26.7 ^(e)
(B) Total Expenditure	163.7	189.0	233.0	257.0	466.2	520.0	550.0
By Type Current	161.3	168.3	203.5	223.6	347.2^(e)	388.8	325.0
Of which:							
- Wage bill	87.4	99.8	117.0	120.5	126.5 ^(e)	140.0 ^(e)	155.0 ^(e)
- Supplies/Services	22.1	19.4	22.9	27.0	31.5	38.4 ^(e)	45.6 ^(e)
- Subsidies	4.4	5.4	5.5	6.0	12.8	14.3	17.6
- Interest	15.3	25.4	34.5	35.5	23.5 ^(e)	18.6 ^(e)	12.5 ^(e)
- Oper. & Maint.	17.4	18.3	23.6	26.0	31.5 ^(e)	45.6 ^(e)	47.6 ^(e)
- Other	14.7	N/A	N/A	8.6	121.4 ^(e)	131.9 ^(e)	47.3 ^(e)
By Type Capital Projects	2.3	20.7	30	33.4	119.0	131.2	225
Budget Balance	-34.7	-46.0	-20	+36	+176.5	+580.9	-45.0
Budget balance as % of GDP at current prices	-6.9%	-10%	-2.9%	4.5%	12.3%	33.0%	-3.3%

Sources: Ministry of Finance, SAMA, IMF Staff Reports (e) estimates

Despite lower budgeted 2010 oil prices, high planned expenditure continues:

- **Budget allocations for autonomous government institutions **have increased** with emphasis on:**
 - **Water projects.**
 - **Expansion in the capacity of the Royal Commission for **Jubail and Yanbu**.**
 - **New universities founded since 2007 (seven new universities) and an increased allocation for existing ones.**

Table 3.6 Saudi Arabia: budget allocations for semi-autonomous institutions (SR million)

	2001	2003	2004	2008	2009
Saudi Arabian Airlines	10,384	11,280	12,580	17,400	19,503
General Sea Ports Authority	501	1,410	1,500	827	1,067
Grain Silos and Flour Mills Organization.	980	1,034	1,168	914	935
Saline Water Conversation Corporation.	3,296	2,245	2,350	5,053	7,645
Royal Commission for Jubayl & Yanbu	2,017	1,010	266	5,583	6,717
General Organization for Military Industries	598	716	774	1,036	1,206
King Abdulaziz City for Science and Technology	296	504	516	857	1,115
Saudi Red Crescent Society	243	295	340	630	1,399
Government Railroad Organization	217	145	143	823	1,147
Saudi Arabian Standards Org.	83	87	98	155	161
Telecommunications Authority		80	100	300	396
Saudi Arabian General Investment Authority	60	80	80	103	136
Supreme Tourism Council	45	125	150	347	384
Saudi Geological Survey	100	111	111	146	164
Institute of Public Administration	222	203	202	288	339
General Org. for Technical Education	1,396	1,540	2,880	3,433	3,735
King Saud University	2,257	2,403	2,420	3,698	5,698
King Abulaziz University	1,433	1,538	1,500	2,467	2,906
Imam Muhammed bin Saud University	1,255	1,250	1,170	1,866	2,192
King Faisal University	700	773	867	2,165	2,742
King Khalid University	356	422	469	1,398	1,974
King Fahd University of Petroleum and Minerals	547	574	622	822	921
Umm-Al-Qura University	743	745	673	1,493	1,693
Islamic University of Madinah	277	288	310	431	493
Taibah University	-	-	-	890	1,150
Qasim University	-	-	309	1,096	1,296
Taif University	-	-	122	775	935
Jazan University	-	-	-	775	935
Al Jawf University	-	-	-	459	694
Hail University	-	-	-	480	588
Tabuk University	-	-	-	364	500.3
Al Baha University	-	-	-	323	445.9
Najran University	-	-	-	320	398.6
Riyadh Girls University	-	-	-	1,357	1,425.6
Northern Borders University	-	-	-	316	444.3

Source: Ministry of Finance, SAMA

Saudi budget surpluses: cyclical or structural?

Evidence seems to suggest that these are

cyclical rather than **structural**. A lack of a tax

revenue mechanism in cyclical surplus

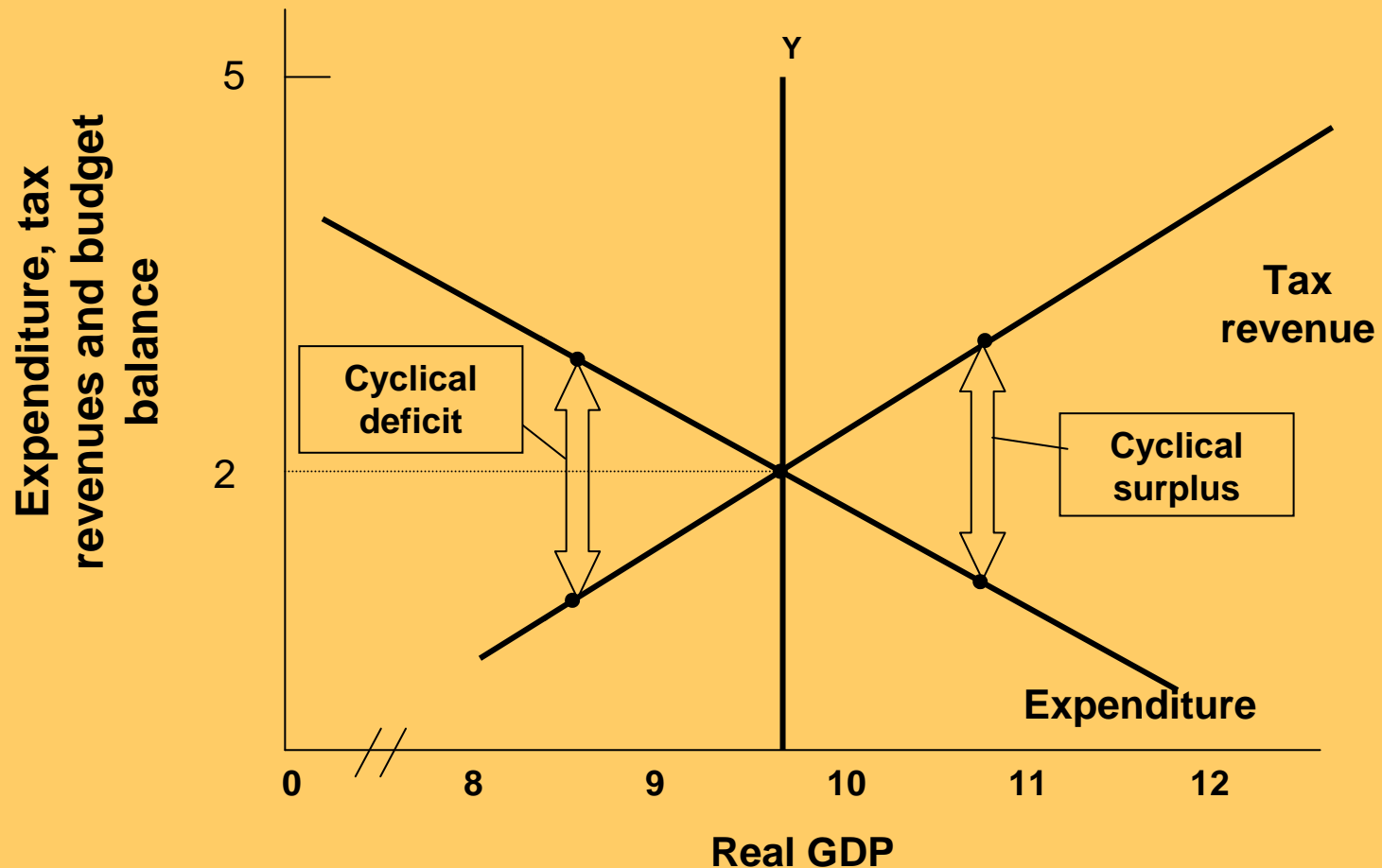
modes, reduces Saudi government's ability to

build up non-oil revenue from this source

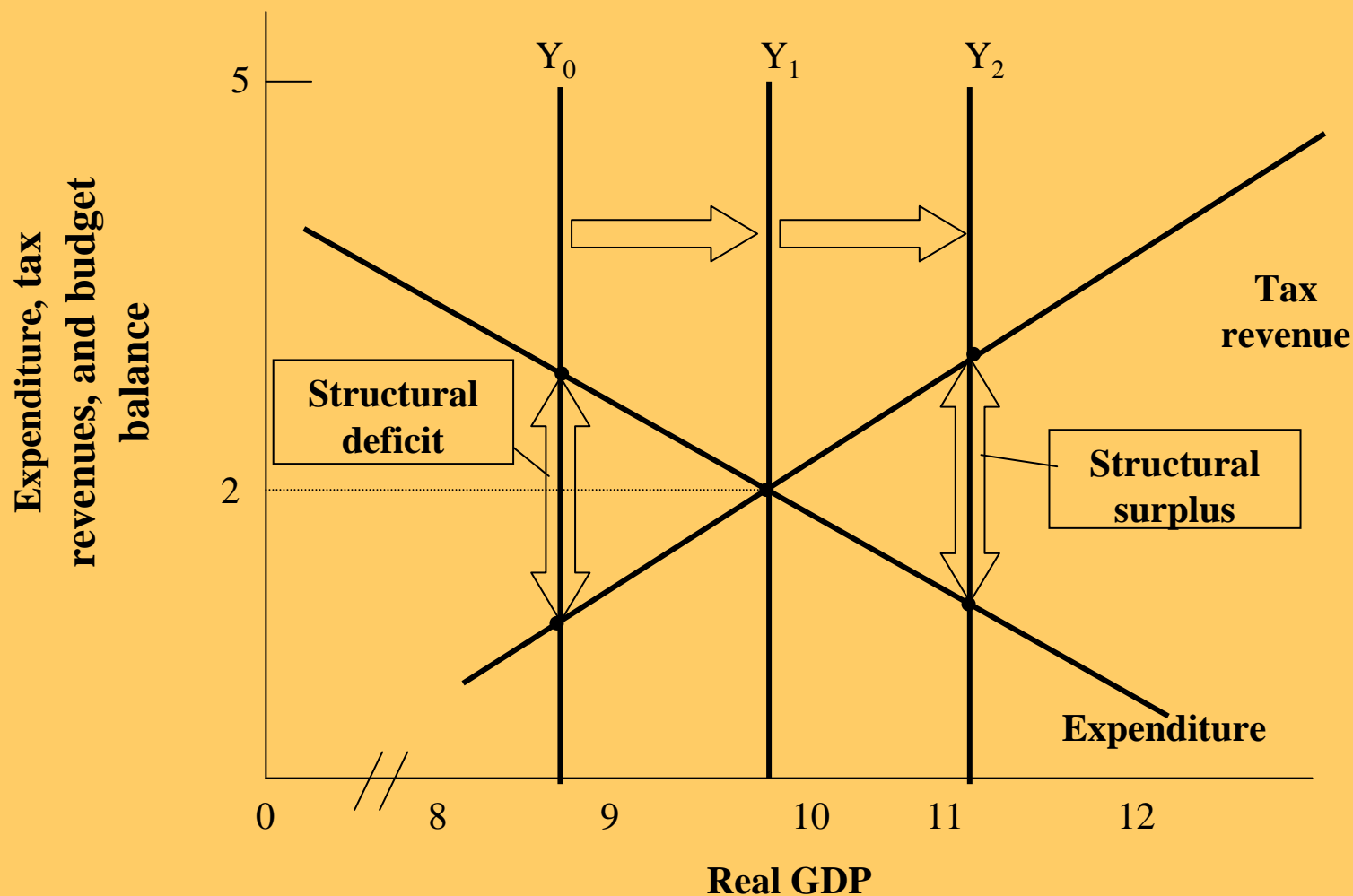
during periods of GDP growth.

Figure 3.9 Cyclical and structural surpluses and deficits

(a) Cyclical deficit and cyclical surplus



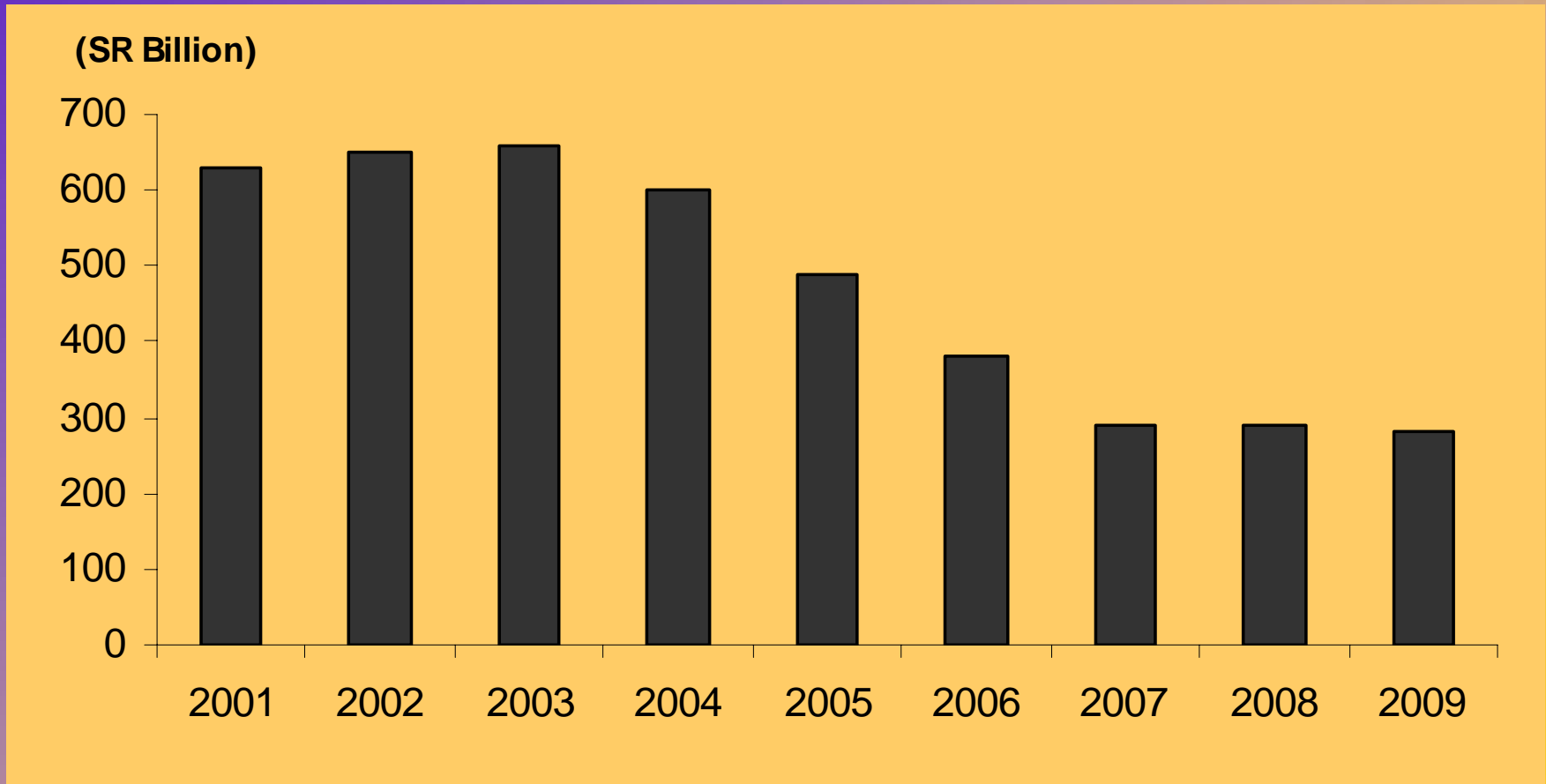
(b) Structural deficit and structural surplus



Burden of indebtedness reduced

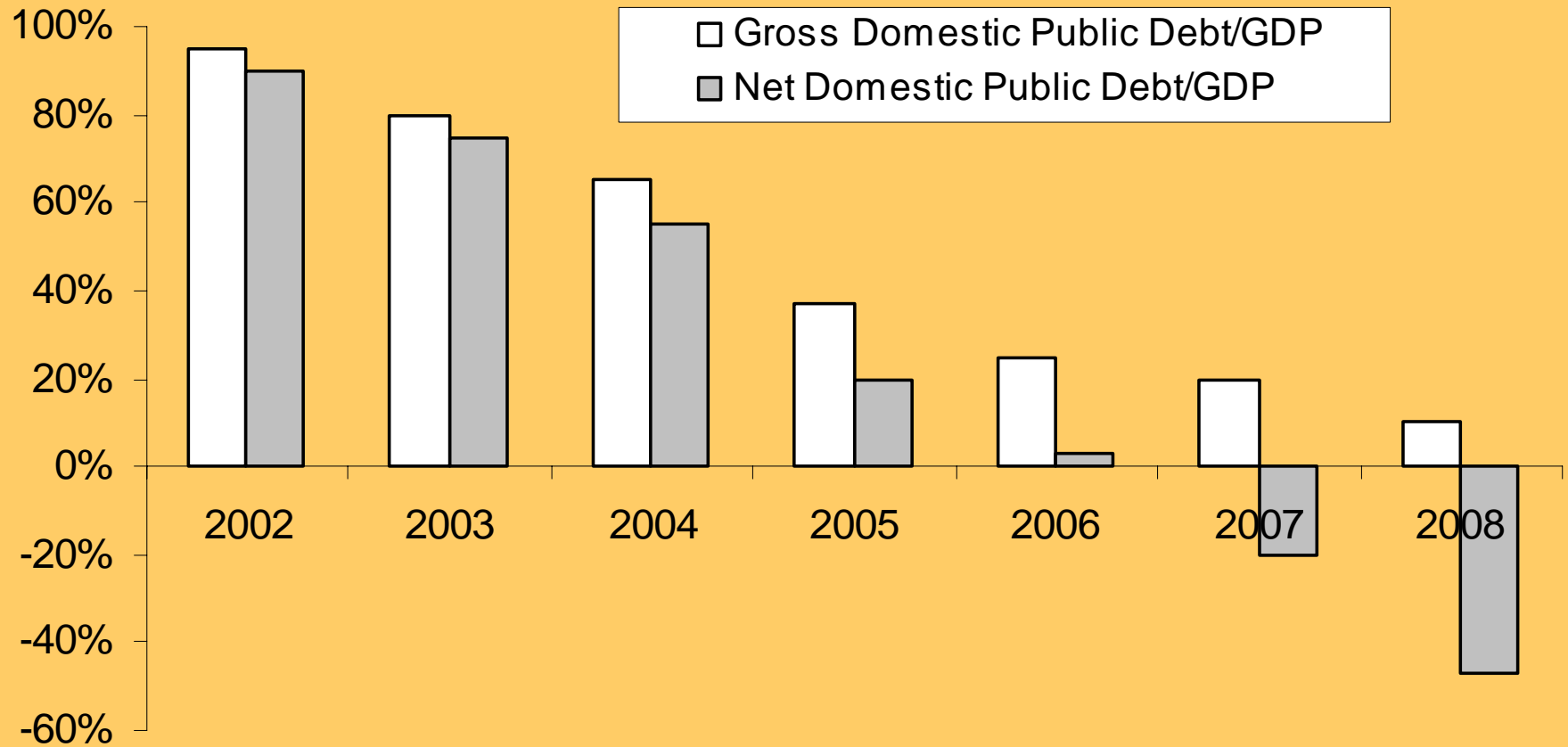
- Gross Saudi government debt has been **reduced** to around 18% of GDP by 2009, from highs of nearly 90% of GDP in the 2002/03 period.
- Net domestic public debt to GDP has fallen sharply by nearly 50% in 2008.

Figure 3.10 Government debt (SR billions) (2001-2009)



Source: Ministry of Finance

Figure 3.11 Domestic public debt – Gross and net to GDP

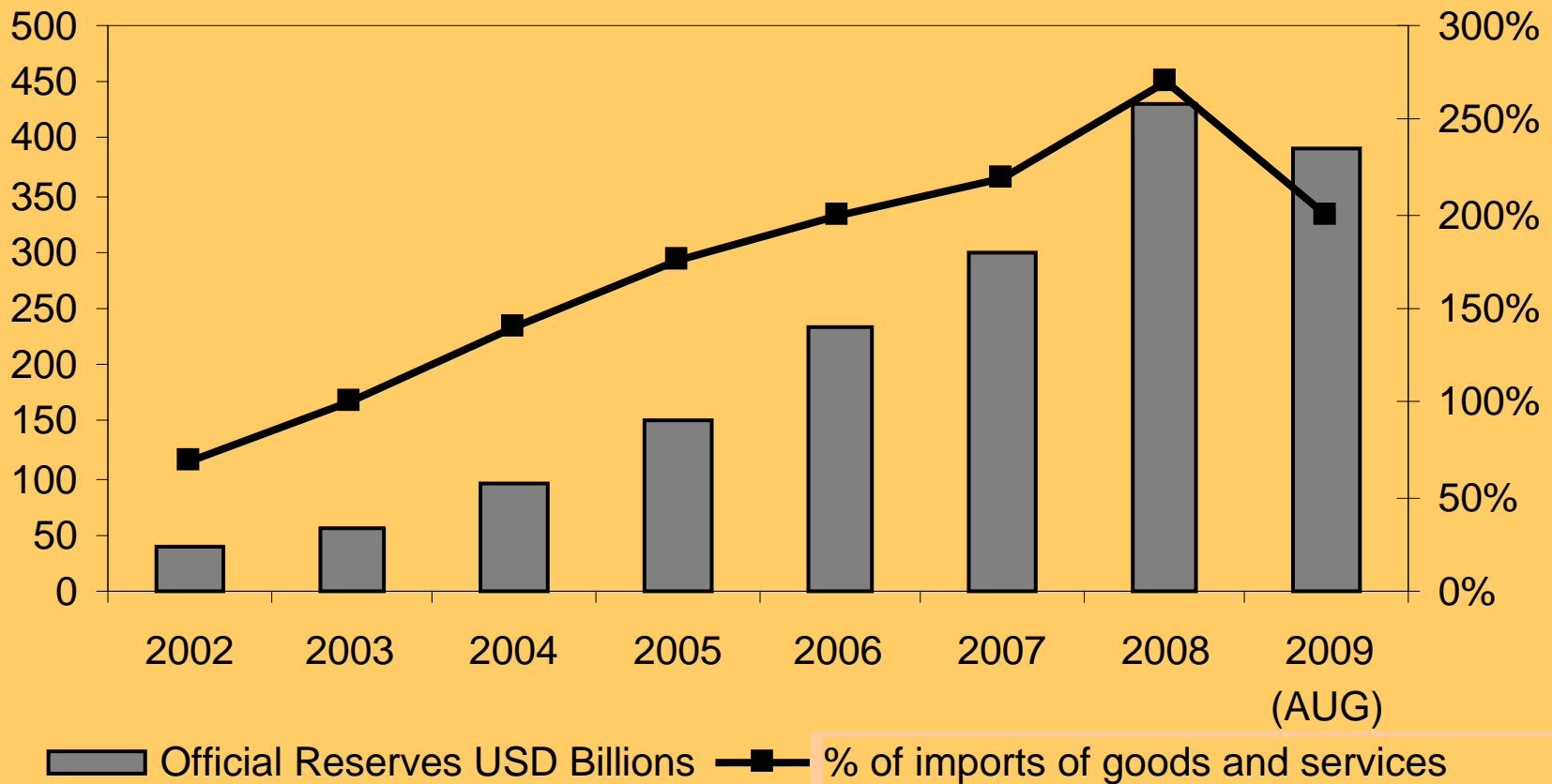


Source: SAMA

Rise in Saudi official reserves has eased pressure on Saudi bank lending to fund government debt.

- **Government debt is now at around 18% of GDP for 2009.**
- **Reserves peaked in 2008 ,to stand at around \$450 billion from around \$100 billion in 2002.**
- **Reserves amount to 250% of total Saudi imports of goods and services in 2009 compared with 25% in 2002.**
- **High reserves has eased back on possible “crowding out” effect on private sector borrowing during high deficit borrowing periods.**
- **By 2009, total government paper held by Saudi banks represented around 15% of total bank assets, compared with 25% in 2003.**

Figure 3.12. SAMA's official reserves



Source: SAMA, Ministry of Finance

Figure 3.13 A crowding-out effect

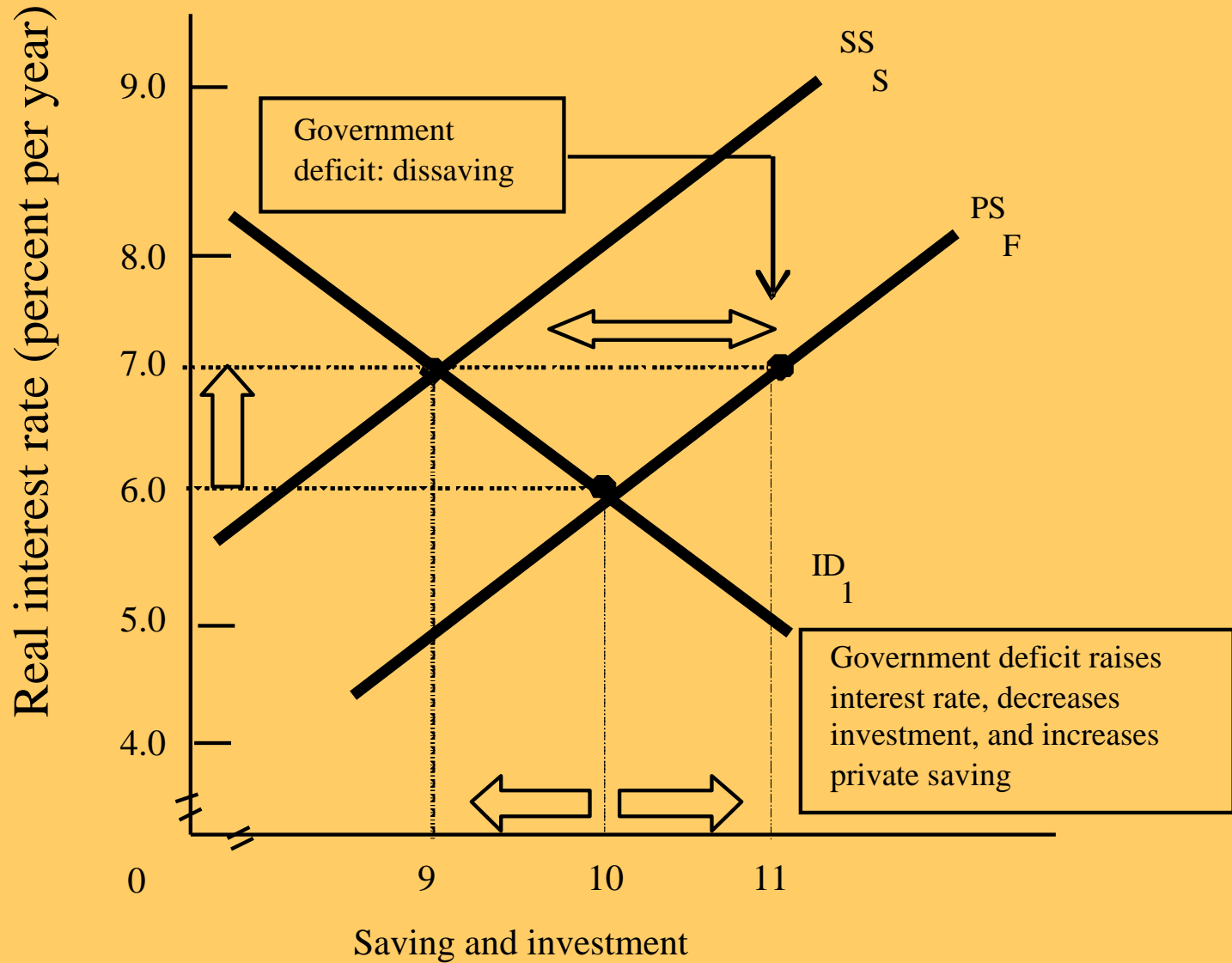
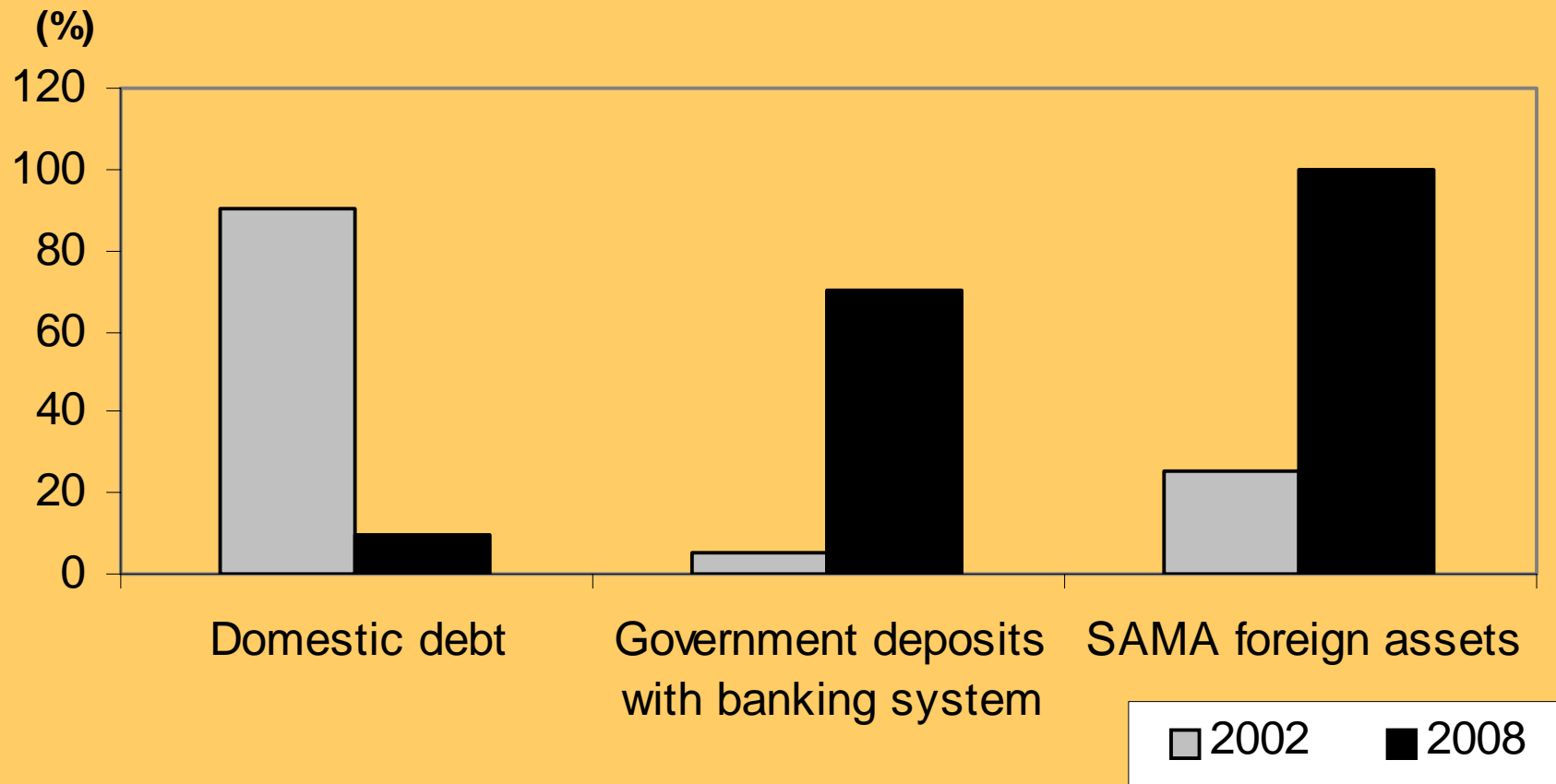


Table 3.7 Government and public sector security holdings by Saudi commercial banks (1996-2009) - (SR billion)

	<i>1996</i>	<i>2003</i>	<i>2008</i>	<i>2009(Aug)</i>
Government paper	65.266	148.346	241.986	200.742
Private Securities	6.627	8.353	21.820	21.040
Total Securities	71.893	156.699	263.806	221.782
Total Bank Assets	357.947	590.532	1,302.271	1,346.392
Government paper as % of Bank Assets	18.2%	25.12%	18.58%	14.91%

Source: SAMA, 2009

**Figure 3.14. Saudi Arabia key financial parameters 2002/2008
(% of GDP)**



Source: SAMA.

Table 3.8 Possible solutions for improving revenue base

<i>Measures</i>	<i>Major Issues</i>
<i>Short term</i>	
i) REVENUE ENHANCEMENT	
• Zakat	The 2.5% zakat on companies (Islamic levy on total assets) is earmarked for social welfare purposes. Better collection efforts could generate marginal increases.
• Custom duties	Better collection of duties and tariffs will be offset long-term by inter-GCC tariff reductions and expected WTO entry.
• Fees and charges	Increasing use of this revenue source has provided some fiscal certainty. Expand current base of fees on government service (expatriate and Saudis) as well as more market-based pricing for subsidized services.
ii) MEASURES	
• Budget adherence	Strict adherence to expenditure limits must be applied. Extra budgetary expenditures to be allowed only from other chapter allocations.
• Reallocation of expenditure items to “best” economic use	Reallocation of expenditures to longer-term productive value-added, job generating sectors and gradual reduction in wasteful subsidies. Close examination of defence expenditure while maintaining security needs.
(Continued....)	

Table 3.8 (continued)

<i>Measures</i>	<i>Major Issues</i>
iii) REVENUE SOURCES	
• Taxation	Reintroduce personal income taxes on both expatriates and Saudis, after studies on poverty threshold levels. Introduce sales tax on luxury goods and value-added tax on range of consumer durable goods.
• Sale of government assets	Speed up sale of key government-owned industries starting with mature ones (banking), Petrochemical (SABIC) and telecommunication (STC). Revenue to be used for debt repayment and capital infrastructure investment.

(Continued....)

Table 3.8 (continued)

Measures	Major Issues
iv) MEASURES	
• Civil service reforms	Needed as much as <i>Saudization</i> policy. Assess efficiency of current public sector expenditure and allocate according to productivity.
• Privatization at fair market prices	Initiate full privatization of key sectors, but shape these around fair market prices to encourage Saudi private capital repatriation by the private sector.
• Studies on fiscal policies	Establish independent Centre for Fiscal Studies to analyse economic effects of taxation measures on consumers, business and government revenue-generating impact.
• Establish efficiency performance benchmarks	There is a lack of clear overall benchmarks for measuring adequacy of government efforts to meet needs of the public and Saudi economic development. Transparency is growing but more is needed on performance relative to public demand and need. This requires benchmarking through meaningful output measures.
<i>(continued)</i>	

Table 3.8 (continued)

Measures	Major Issues
<ul style="list-style-type: none"> Stabilisation fund 	<p>Establish a “Revenue Stabilisation Fund” to be allocated a specified percentage of annual revenues or surpluses and to be used for budgetary revenue stabilization under strict drawdown guidelines.</p>
<ul style="list-style-type: none"> Regional/municipal level economic empowerment 	<p>Empower local municipalities and regional economic councils with budgetary allocations and responsibilities. This will result in local prioritization of economic resources and accountability for upcoming municipal elections.</p>
<ul style="list-style-type: none"> Introduce “mini” budgets 	<p>Current yearly budget announcement and planning is not proactive enough given fluctuating world economic conditions and oil prices. Introduction of bi-annual “mini-budget” announcement will adjust forecast of revenues and expenditures accordingly. Ministry of Finance will become more focused on fiscal stabilization programmes as well as more accurate macro economic production.</p>
<ul style="list-style-type: none"> International borrowing 	<p>Reinforces financial discipline and obligations. Apply the “golden rule” – borrow to invest and not for the current expenditures. Less burden on domestic banks.</p>

Conclusion

- There are **no easy options** as no **single** measure to diversify national income can be a remedy, but a combination of short and long term measures can work.
- Privatization and use of proceeds could relieve government from the running of state operations.
- **Oil stabilization fund** could assist in times of erratic oil revenues.
- Efficiency in government expenditures and obtaining **“value-for-money”** is important.