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The Saudi Arabian Economy

Policies, Achievements and Challenges

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CHAPTER 2

Reforms and Economic Planning

Economic diversification remains critical

- Reducing dependency on oil revenues is critical for long term diversification.
- This involves both judicial and structural reforms.
- **King Abdullah** has been instrumental in:
 - Updating the Succession Law of the Kingdom
 - Introducing judicial independence and modernization
 - Empowerment of the **Majlis Al Shoura** (*Consultative Assembly*)
- National economic planning models have evolved to take account of different development options.

TABLE 2.1 Saudi Arabia: Economic Development Options

<i>Development option</i>	<i>Positive Factors</i>	<i>Negative Factors</i>
Large oil production	<ul style="list-style-type: none"> • Large foreign investments and surplus financial resources • Balance of payment surpluses • No incentive to fund crude oil substitutes 	<ul style="list-style-type: none"> • Economic dependency • International and domestic inflation • Rapid consumption of non-renewable national resources. • Rentier economy
Oil production based on domestic needs	<ul style="list-style-type: none"> • Moderate investments abroad leading to paced development and equilibrium between domestic development needs and financial resources. • Large oil reserves for future generations 	<ul style="list-style-type: none"> • World oil shortages • High international inflation and world recession • Strong incentive to find crude oil substitute and suppliers
Large scale domestic industrialization and diversification of economic base	<ul style="list-style-type: none"> • Potential economic independence • Skills acquisition and new working habits. • Exports potential • Technology transfer • Education base widened • Non-oil economic diversification 	<ul style="list-style-type: none"> • Large imports • Need for expatriate labour increased • Balance of payments problems with a large element of exported salaries and profits • Domestic inflation • Institutionalized inefficiency due to subsidy policy (import substitution industry). • Mismatch between domestic labour supply output and market requirements.

National economic priorities have changed

- Saudi Arabia is now in the 9th Development Plan (2010-2014)
- Major emphasis is now on human resources(50% of expenditure) as well as social and health development over the plan periods.
- Planning paradigm has shifted from “directive” to “indicative”
- Poverty eradication is now a key objective.

Table 2.2 Expenditures during the Saudi development plans

<i>Expenditures</i>	<i>Economic Resources Development</i>		<i>Human Resources Development</i>		<i>Social and Health Development</i>		<i>Infrastructure Development</i>		<i>Total</i>	
	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)	SR Billion	(%)
First Development Plan:										
1970 - 1974 (Actual)	9.5	27.7	7.0	20.6	3.5	10.3	14.1	34.1	34.1	100
Second Development Plan:										
1975 - 1979 (Actual)	97.3	28.0	51.0	14.7	27.6	8.0	171.3	347.2	347.2	100
Third Development Plan:										
1980 - 1984 (Actual)	192.2	30.7	115.0	18.4	61.2	9.8	256.8	635.2	635.2	100
Fourth Development Plan:										
1980 - 1989 (Actual)	71.2	20.4	115.1	33.0	61.9	17.7	100.7	348.9	348.9	100
Fifth Development Plan:										
1990 - 1994 (Actual)	34.1	10.0	164.6	48.0	68.0	20.0	74.2	340.9	340.9	100
Sixth Development Plan:										
1995 - 1999 (Actual)	48.2	11.5	216.6	51.5	87.5	20.8	68.1	420.4	420.4	100
Seventh Development Plan:										
2000 - 2004 (Actual)	54.4	11.2	276.9	57.1	92.6	19.1	61.4	12.6	485.3	100
Eighth Development Plan:										
2005 - 2009 (Actual)	105.8	12.2	479.9	55.6	155.7	18.0	122.3	14.2	863.7	100

Source: Saudi Ministry of Planning, September, 2002, 2005

National Planning key indicators have changed

- Employment generation and **Saudization** are now key priorities.
- Other indicators are development of human resources, quality education and enhancing national competitiveness.
- Knowledge based economy growth and opening up the economy to globalization is now emphasized.
- Women issues and human rights are also important indicators.

Table 2.3 Saudi Arabia's national five year development plans: key indicators

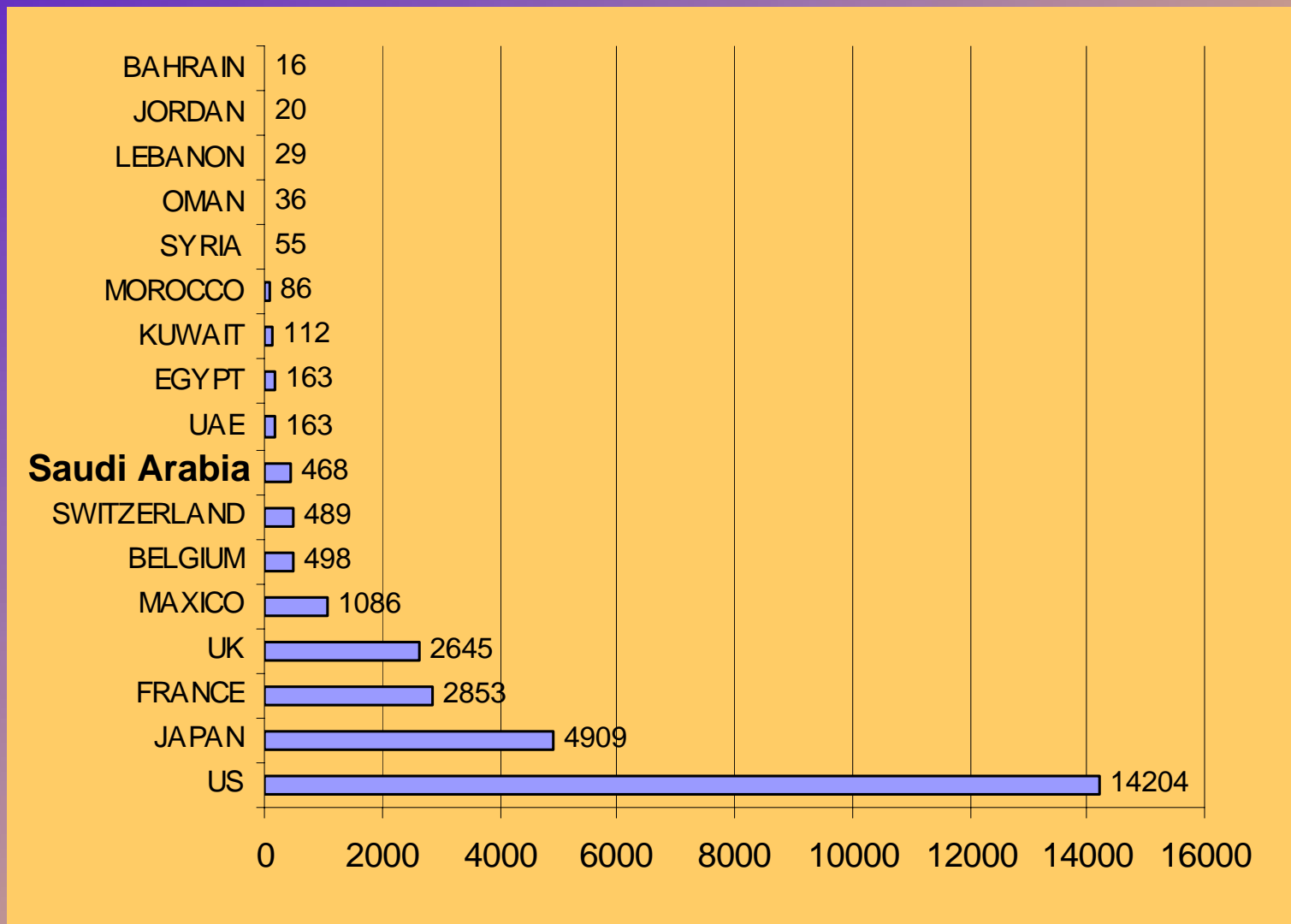
<i>Overall national priorities</i>	<i>First (1970 - 1979)</i>	<i>Third (1980-1984))</i>	<i>Fourth (1985 - 1989)</i>	<i>Sixth (1995 - 1999)</i>	<i>Seventh (2000 - 2004)</i>	<i>Eighth (2005-2009)</i>	<i>Ninth (2010-2014)</i>
<ul style="list-style-type: none"> • Safeguard Islamic values in conformity with <i>Shariah</i>. • Improve standard and quality of life • Develop human resources, increase productivity and replace non-Saudis with qualified Saudis • Realize balanced growth in all regions • Diversify economic base and reduce dependence on production and export of oil • Provide favourable environment for activities of the private sector to encourage it to play a leading role in development. 	<ul style="list-style-type: none"> • Focus on provision of modern infrastructure, basic government services • Expansion of human resources and beginning of infrastructure growth. • Starting hydrocarbon industries • Establishment of modern administrative infrastructure 	<ul style="list-style-type: none"> • Expanding Infrastructure, economic resources • Human resources and educational base expansion • Hydrocarbon base expansion • Undertaking regional economic initiatives 	<ul style="list-style-type: none"> • Concentration on operation and maintenance • Reconstructing the economy to allow more private sector participation • Human Resources and health expenditure rose. • Shift from Central planning projects approach to programme planning approach 	<ul style="list-style-type: none"> • Human resources emphasis as well as social and health. • Aiming for balanced budget. • Reduction in foreign Labour • Private sector expansion • Beginning of partial privatization • Reduction of subsidies. 	<ul style="list-style-type: none"> • Solving human resource problems • Diversify the economy • Increasing gas production • Consolidating efficiency in production, refining and distribution. • Reducing State budget deficit • Increasing Saudization • Preparing for globalization, WTO. • Privatization as strategic option 	<ul style="list-style-type: none"> • Increase number of new entrants to labour market • Develop human resources and upgrade efficiency • Enhance national economic competitiveness and integrate into international economies • Enhance private sector participation • Develop Science and Technology system as base for economy • Reduce regional development disparities • Upgrade human's capabilities and remove constraints that impede their participation. 	<ul style="list-style-type: none"> • Raise standard of living of citizens. • Diversify economic base. • Move towards knowledge based economy. • Strengthen role of private and public sector cooperation. • Continue institutional reforms. • Develop SME sector. • Bolstering human rights. • Achieve balanced regional development. • Promote economic integration with GCC and other powers.

Source: Ministry of Planning.

Saudi GDP: growing but is small compared to developed economies

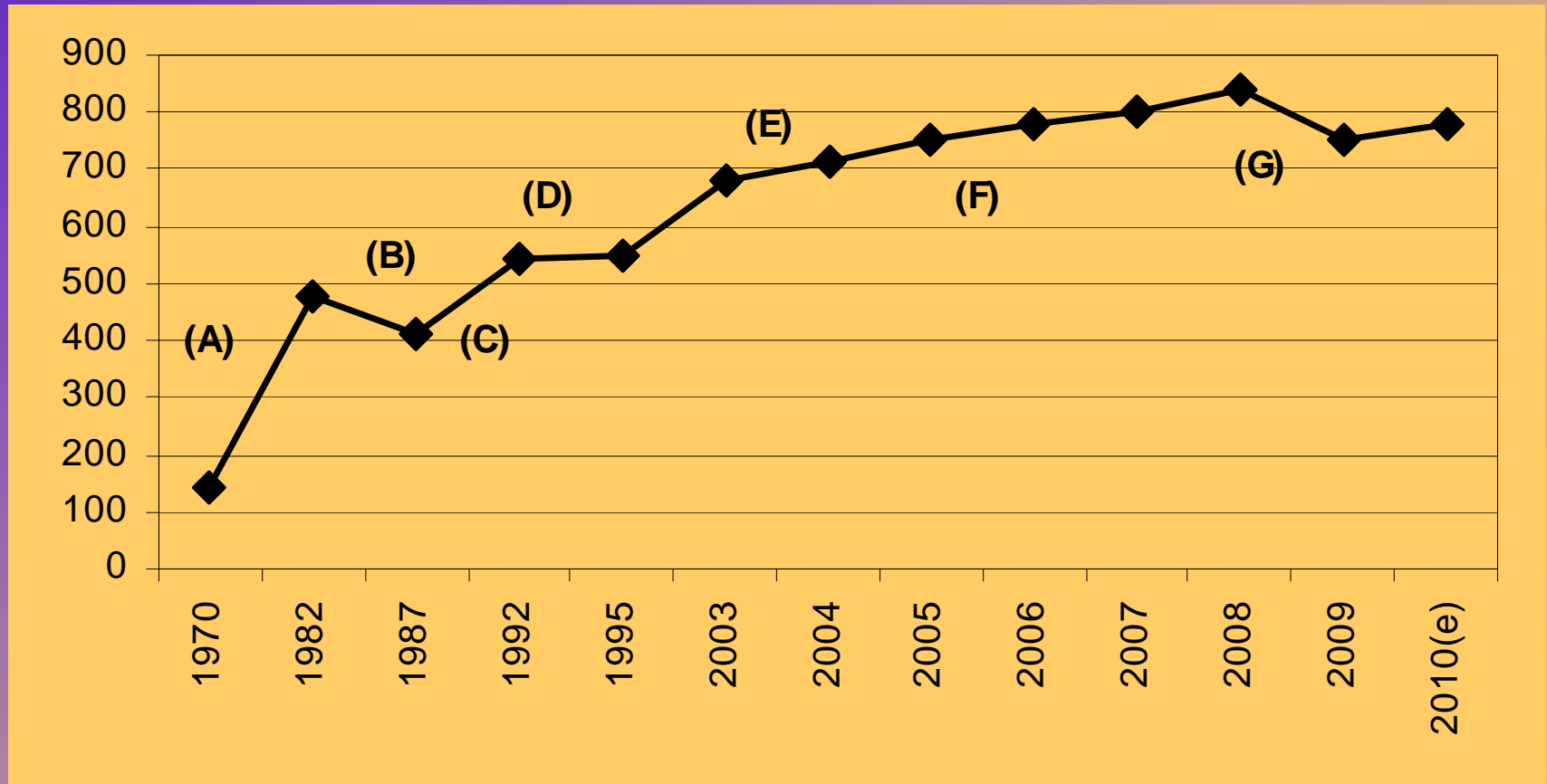
- **Largest in Arab world but smaller than Belgium or Switzerland.**
- **Prone to erratic business cycles of boom and slowdown.**
- **Primarily oil driven.**

Figure 2.1. 2008 GDP comparison (US \$ billions)



Source: *World Bank*, 2010.

Figure 2.2. Saudi Arabia: major business cycles GDP 1970 - 2010
(SR billions at constant prices. (1999 = 100))

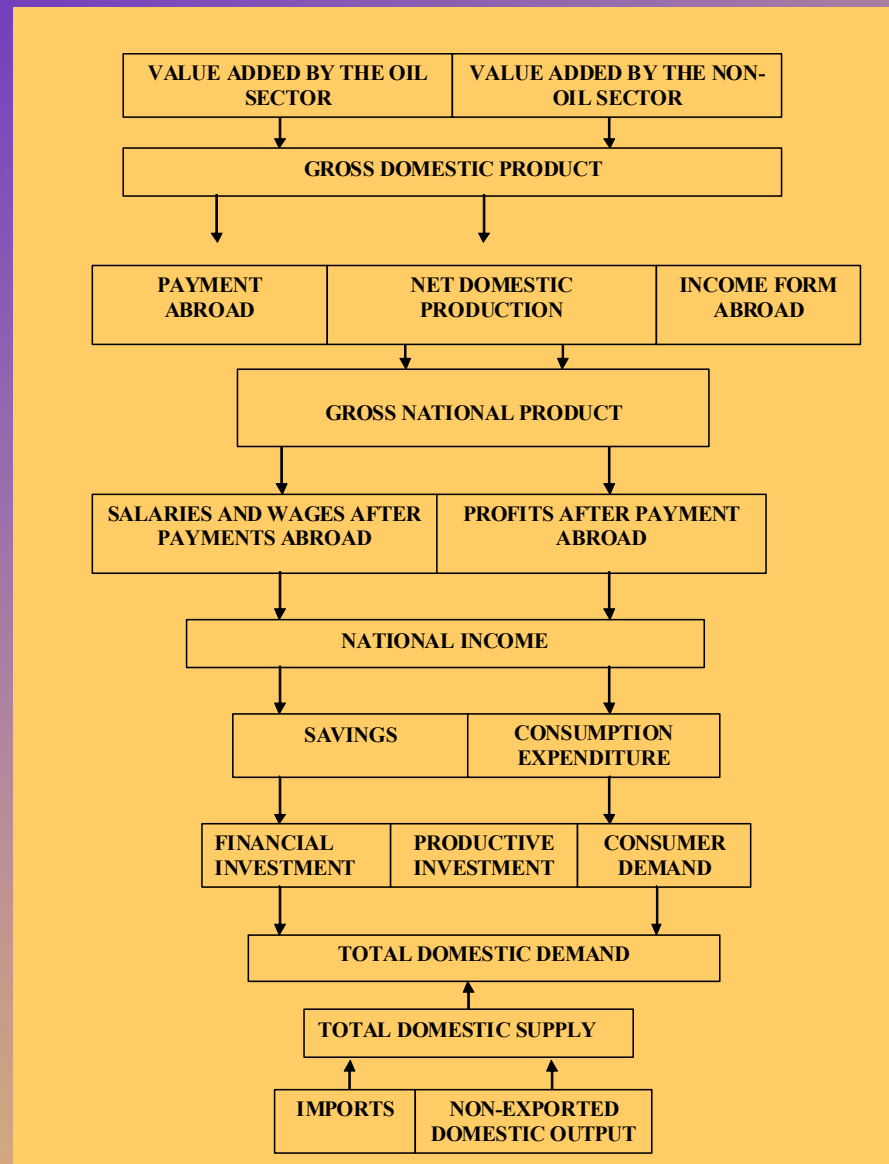


Source: SAMA, 2009, Estimate 2010

Saudi Arabian economy is still dominated by oil flows

- **Major driver of economic activity.**
- **Affects all macro-economic variables – saving, expenditure, investment and demand.**
- **Major effect on imports and flow of foreign remittances.**

Figure 2.3 Saudi Arabian model of economic flows



Adapted from Cleron, 1978, p. 74.

Table 2.4. Remittances from Saudi Arabia (SR billion)

<i>Year</i>	<i>GDP at constant prices (1999=100)</i>	<i>Private transfers</i>
1970	148.0	0.81
1976	416.5	3.5
1982	480.5	18.0
1993	552.7	58.8
1995	557.6	62.2
1998	608.1	56.0
2000	632.9	57.7
2001	641.2	56.9
2002	647.7	59.4
2003	686.0	55.4
2004	722.2	50.8
2005	762.3	52.4
2006	786.3	58.5
2007	812.4	60.2
2008*	848.5	79.5

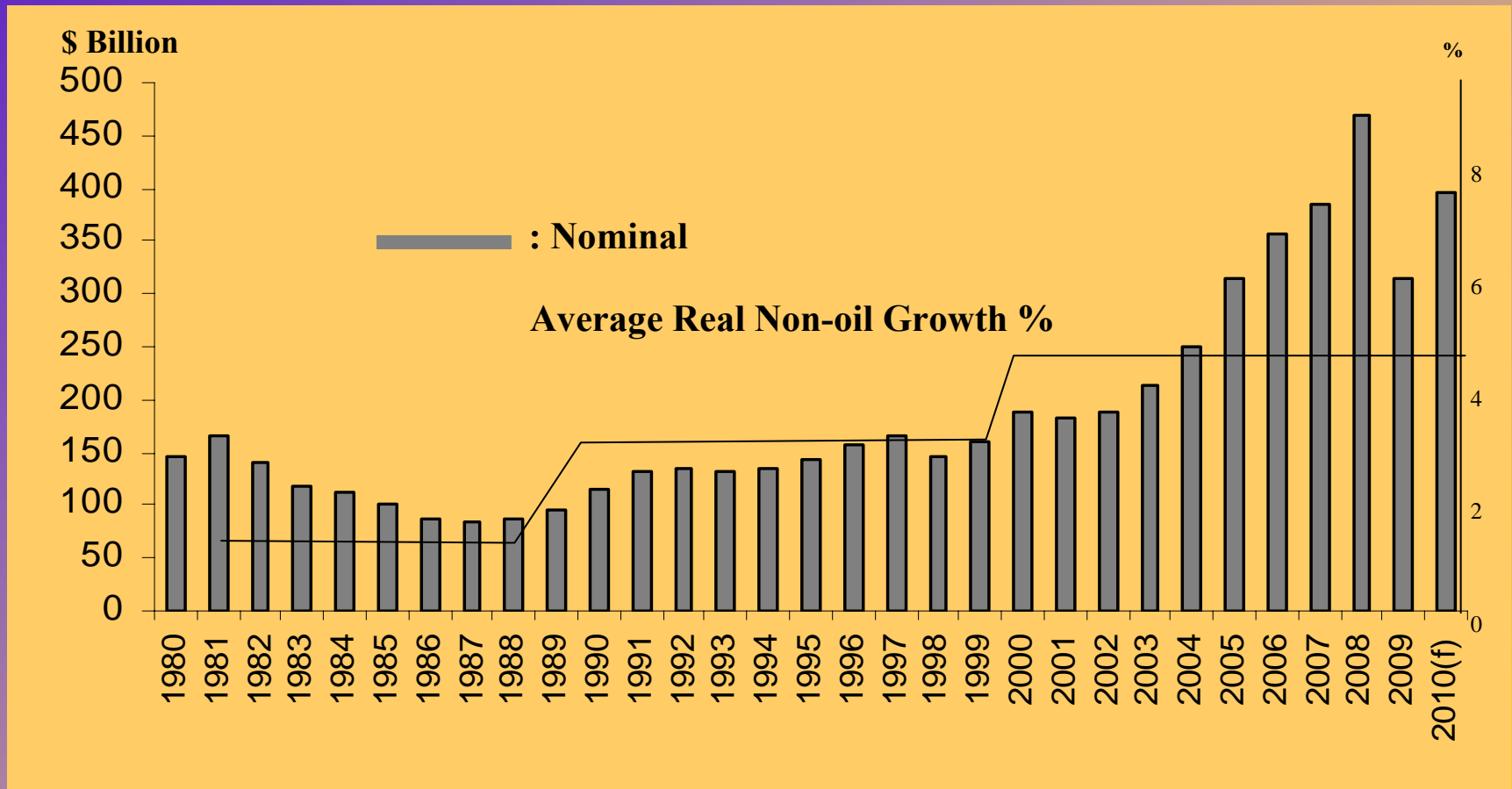
Source: SAMA, 2009.

*** Provisional**

Non-oil GDP has grown steadily

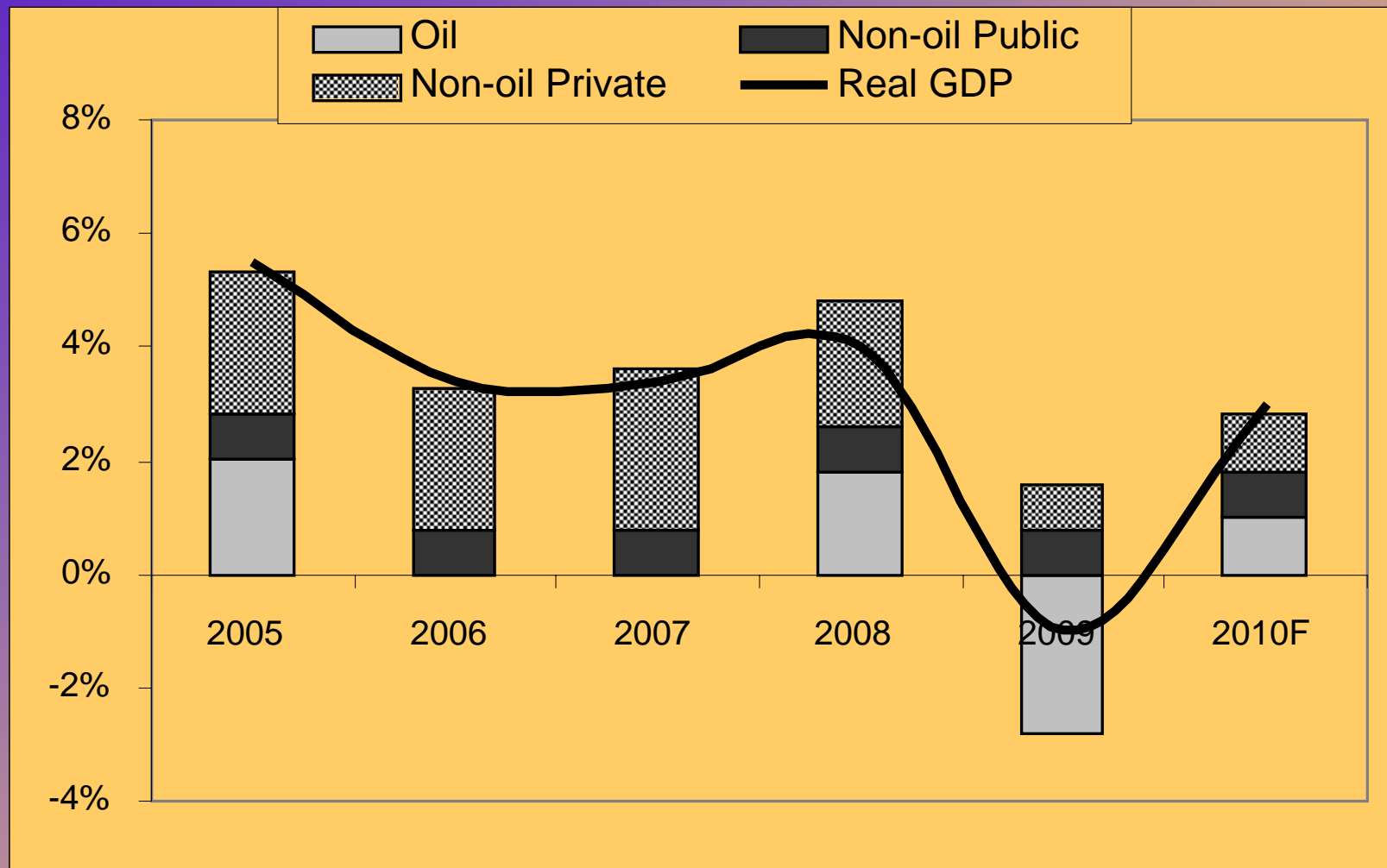
- A positive indicator for a more diversified economic base.
- **Non-oil GDP** growth has been averaging at over 4.5% since 1999 , despite erratic oil revenues.
- Oil sector fluctuations have been a drag on real GDP growth.

Figure 2.4. Historical GDP Growth Developments



Source: SAMA, IMF, estimates.

Figure 2.5. Real GDP growth sector contribution (2005-2010)

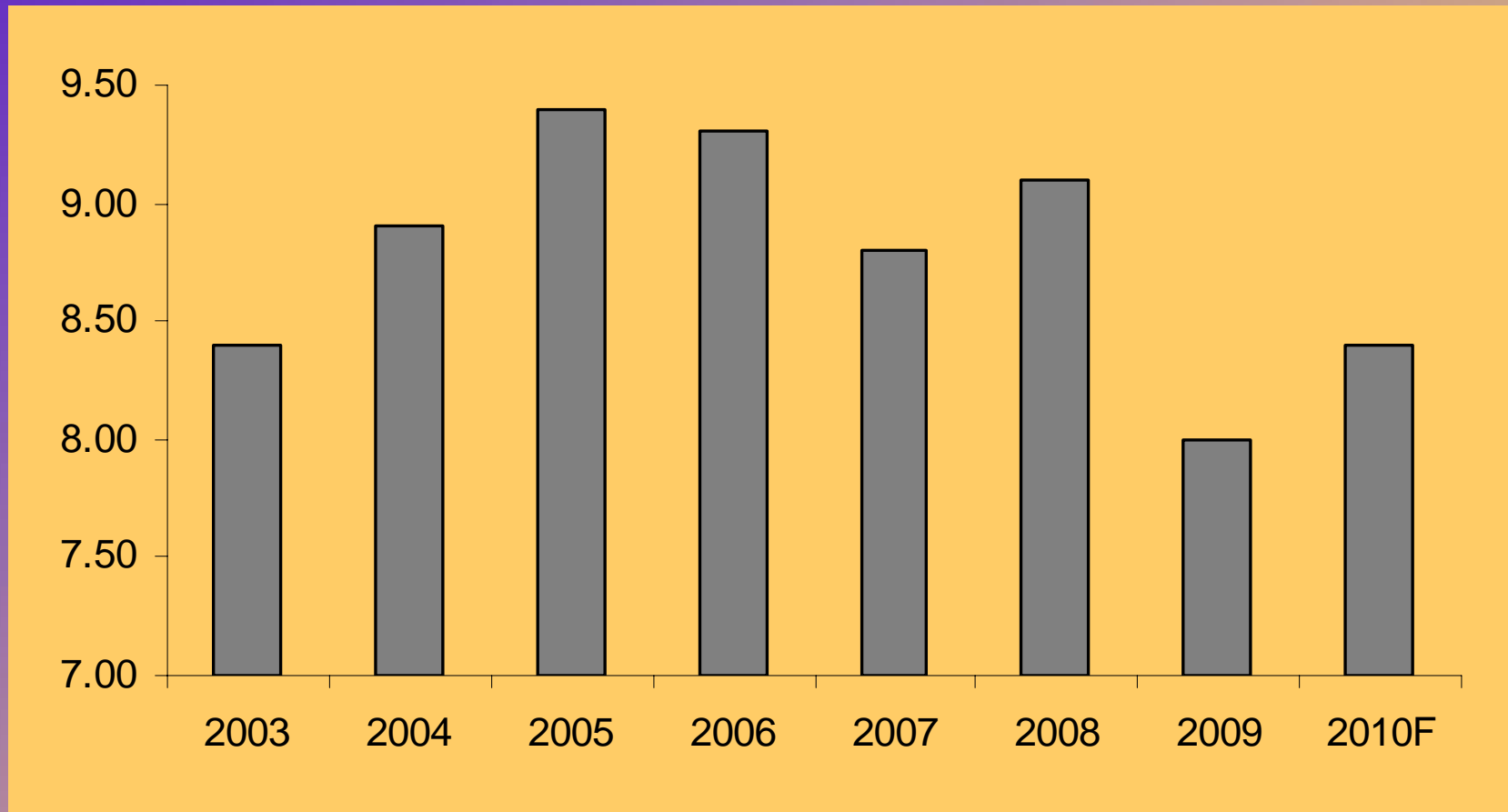


Source: SAMA, forecast

Saudi oil production: erratic trends

- **The 2008/2009 global financial crisis and world economic slowdown brought down production levels.**
- **The steady increase in upward production was broken in 2008, with a modest increase in production forecasted for 2010 (8.5 million b/p day), compared with 9.1 million barrels p/day in 2008 when prices reached \$ 147 per barrel.**

Figure 2.6. Average Saudi crude oil production: 2003-2010
(Million barrels per day)



Source: OPEC, SAMA

GDP by economic sector: oil still predominates

- **Oil still accounts for a significant size of GDP.**
- **Manufacturing sector is around 10%, but with petroleum and petrochemical manufacturing being leading contributors.**
- **Construction is an important sector, around 8% of GDP, while agriculture, despite massive subsidies, is around 5% of GDP.**
- **Growing importance of the financial sector, trade and retail in Saudi GDP.**

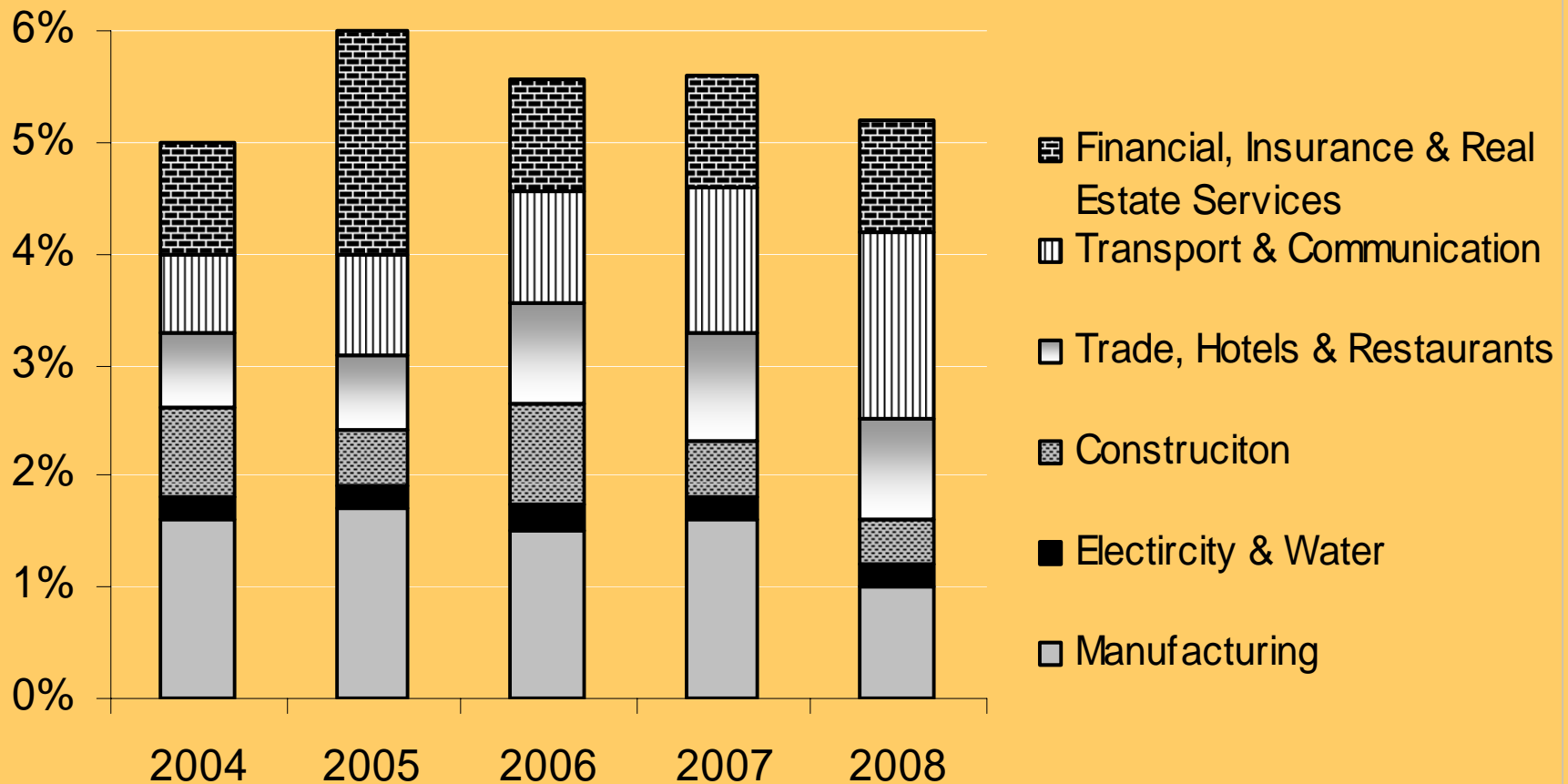
Table 2.5 Gross domestic product by sectors and types of economic activity in producer's values (SR Million)

	1969	1984	2000	2004	2009
<u>Non-oil sectors</u>	8,870	227,130	370,400	525,267	677,239
<u>Producing sectors</u>	3,790	85,280	150,400	178,250	234,214
Agriculture, Forestry & Fishing	990	11,620	35,570	38,005	44,399
Non-oil mining	50	1,860	2,520	2,723	3,982
<u>Manufacturing</u>	1500	27,430	58,740	79,476	107,206
Petroleum refining	1090	13,830	21,590	20,508	25,443
Petrochemicals	N/A	540	7,080	7,352	10,446
Other manufacturing	410	13,060	30,070	51,616	71,317
Electricity, gas, & water	260	590	970	11,085	13,589
Construction	990	44,960	52,600	46,961	65,038
<u>Service sectors:</u>	5,080	141,850	220,000	211,953	280,133
Trade hotels, etc.	990	30,390	39,250	57,299	73,980
Transport, storage & communications	1230	23,850	34,780	36,674	52,727
Finance, insurance, real estate and business services (1/)	950	25,830	24,060	90,724	121,103
Community, social & personal service	230	9,710	15,210	27,256	32,323
Government services	1680	52,070	106,700	135,064	162,892
<u>Oil product sector:</u>					
Crude oil & natural gas	7740	120,300	269,320	196,696	225,049
Gross domestic product in producer's values	16610	347,430	639,720	721,963	902,288
Import Duties	270	3,970	9,620	7,063	7,122
Gross domestic production in purchasers' values	16,880	351,400	649,340	729,026	909,410

Note:(1/) Net of imputed bank services charges

Source: Ministry of Planning, 2004, SAMA, 2009.

Figure 2.7 Non-oil GDP growth and sector contribution

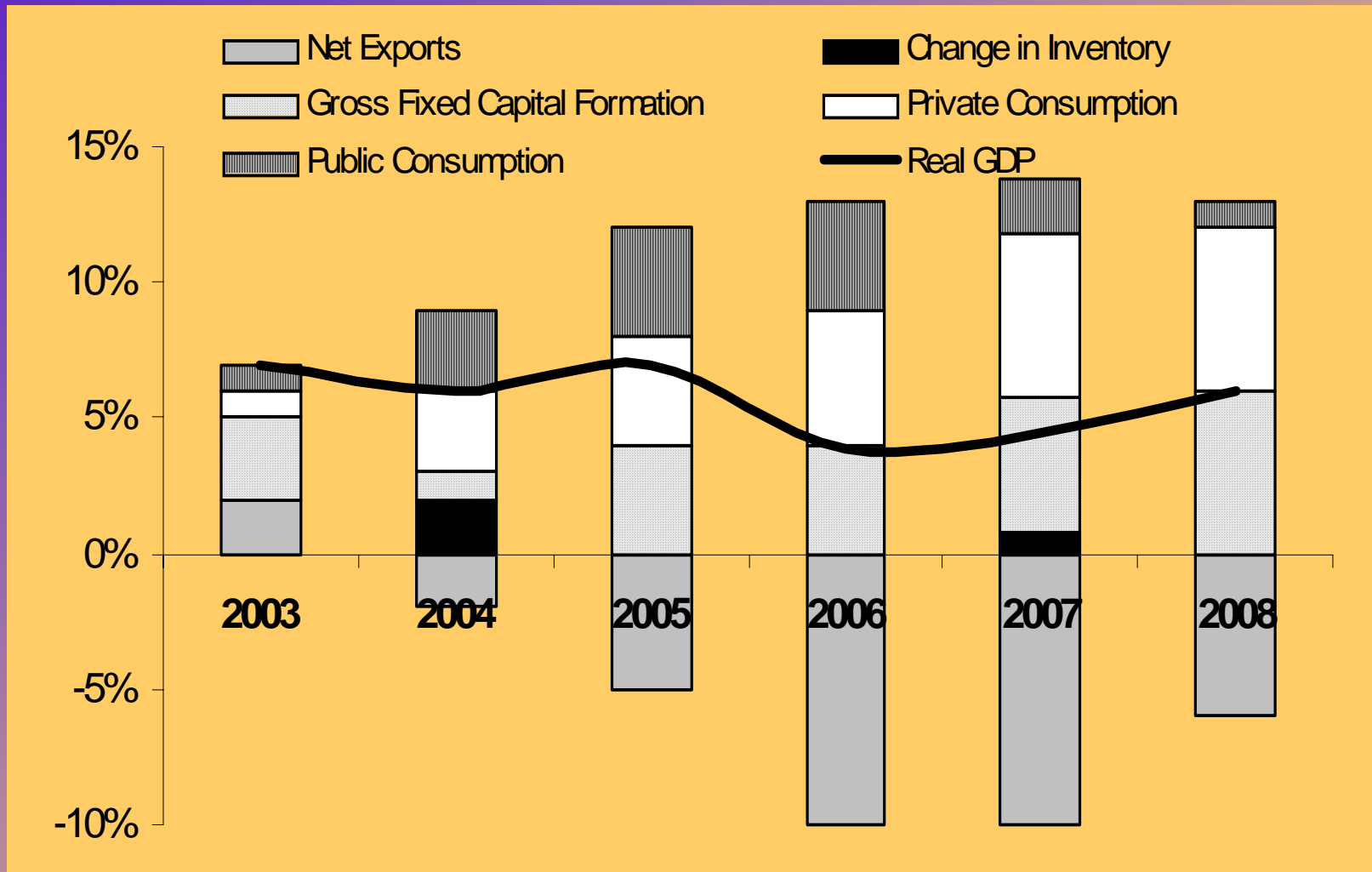


Source: SAMA

Real GDP growth by expenditure pattern

- **Gross Fixed Capital Formation** is now becoming an important element in GDP growth, representing around 30% of GDP in 2008, compared with 20% levels in 2004/2005.
- **Private consumption** is a strong driver, while public consumption pattern has been more erratic.

Figure 2.8. Real GDP Growth by Expenditure

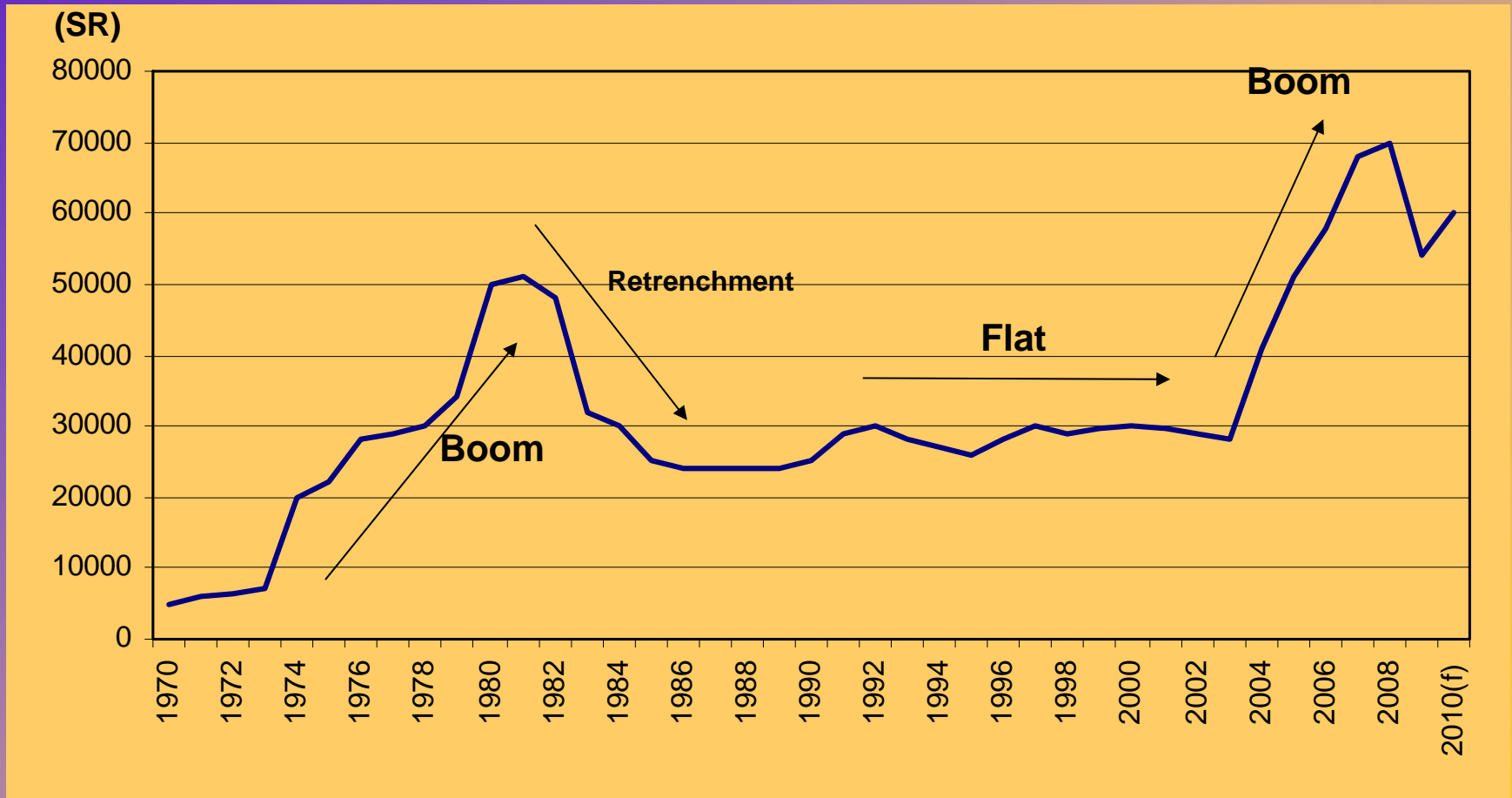


Source: SAMA

Per Capita Income has been erratic

- Per capita income rose to SR 70,000 in 2008, compared with SR 5,000 in the early 1970's.
- Erratic oil revenues and a high population growth rate has **eroded** the per capita income.
- If one takes into account inflation levels since the 1970's, then in **real terms** GDP per capita is around SR 35,000 for 2008, using 1999 as base year.

Figure 2.9. GDP per capita (current SR)



Source: SAMA, 2009

f = forecasted

Non-oil private sector levels rise in Gross Domestic Fixed Capital Formation (GDFCF).

- **The non-oil private sector GDFCF has been taking the lead over the past few decades.**
- **Major investment is in construction (both residential and non-residential), as well as in transport and machinery equipment.**
- **Oil sector investment has picked up since 2005.**

**Table 2.6. Gross domestic fixed capital formation by sectors
& type of assets in purchasers values**

<i>(Million SR)</i>					
	1969	1974	2001	2005	2007
a. By Sector					
Oil Sector	350	3,180	14,240	22,231	50,700
Non-oil Sectors	2,350	9,650	111,855	173,401	235,543
Private	1,000	4,300	94,347	118,461	140,304
Government	1,350	5,350	17,508	54,940	95,239
Total (GDFCF)	2,700	12,830	126,095	195,632	286,243
b. By Type of Assets					
Construction	2,100	9,520	57,909	93,620	138,627
Residential buildings	610	2,320	28,302	31,973	37,823
Non-residential	1,490	7,200	29,607	61,647	100,804
Transport equipment	290	1,470	21,004	28,804	35,168
Machinery & equipment	310	1,840	37,472	55,922	87,504
Total (GDFCF)	2,700	12,830	126,095	195,632	286,243

Source: SAMA, 2009.

Challenges ahead: conditions for growth and the engines of growth

- **Pre-conditions of growth** are essential for sustained development. These involve both a macro-economic positive environment and other enabling conditions.
- **Engines of growth** are important for ensuring a “take-off” in the economy and involve capital accumulation, innovation, R+D, export diversification etc.

Table 2.7. Saudi Arabia: necessary conditions for growth

Legend: ↑ High importance, ↓ Low importance, → Neutral

Factor	Component	Saudi Arabian setting
<u>Necessary conditions for growth</u>		
• Macroeconomic stability	- Government deficits	↓
	- Inflation	↑
	- Exchange rate stability	→
	- Solvency of financial system	↑
• Deep financial markets	- Interest rate spreads	→
	- Developed equity markets	↑
	- Sophistication of financial system	↑
• Openness to international trade	- Low import tariffs	→
	- Low hidden import barriers	↓
• Quality of government	- Public expenditure not wasteful	↑
	- Subsidies improve productivity	↑
	- Senior management spend little time with government officials	↑
	- Admin. regulations burdensome	↑
• Infrastructure	- Road quality	↑
	- Efficient electrical generation	↑
	- High level of competition in provision of basic infrastructure	↑
• Education	- Years of schooling in population	↑
	- Perceived quality of education	↑
	- Companies invest in training	↑
• Rule of law	- Independent judiciary	↑
	- Ability to successfully litigate against government	→
• New economy	- Internet hosts	↑
	- Computers per capita	↑
	- Development of laws in support of new economy	↑

Adapted from *the Arab World Competitiveness Report 2002 –2 003*. pp. 10 – 11.

Table 2.8. Saudi Arabia: Engines of growth, current status

Legend: ↑ High importance, ↓ Low importance, → Neutral

<i>Factor</i>	<i>Component</i>	<i>Saudi Arabian Setting</i>
<u>Engines of growth</u>		
• Start-ups and entrepreneurship	- Administrative barriers to start ups	↑
	- Venture capital availability	↓
	- Loans available with low collateral	↓
• Capital accumulation	- National savings rate	↑
	- Investment rate	→
	(Gross Fixed Capital Formation)	
• Taxation	- Income tax rate	N/A
	- Corporate tax rate (foreigners only)	↓
	- Value added taxes	N/A
	- Tax system perceived to improve competitiveness	N/A
• Innovation	- Highly rated research institute	↓
	- Business conducts R+D	↓
	- Close collaboration between universities and businesses	↓
	- Government supports research	↑
	- High expenditure on R+D	↓
• Transfer of technology	- Foreign direct investment brings new technology	↑
	- Licensing pursued to obtain foreign technology	↑
• Export diversification	- Exports other than national resources	↓

Source: Adapted from *Arab World Competitiveness Report 2002 – 2003*.

Conclusion

- Long awaited structural changes have not yet produced the desired diversified economic base.
- Expansion has been in non-manufacturing services and construction sectors.
- Private sector GDP contribution is still the **necessary ingredient** to generate the large number of jobs to meet national development plan objectives.