May 18, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/61-2

2:30 p.m., July 10, 2019

2. Saudi Arabia—2019 Article IV Consultation

Documents: SM/19/167 and Correction 1; and Supplement 1; SM/19/170

Staff: Callen, MCD; Koeva Brooks, SPR

Length: 1 hour, 12 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
M. Raghani (AF)	
	J. Di Tata (AG)
	N. Heo (AP)
A. Tombini (BR)	
	P. Sun (CC)
	A. Guerra (CE)
	A. McKiernan (CO)
R. Kaya (EC)	
	A. Castets (FF)
	K. Merk (GR)
S. Gokarn (IN)	
	M. Psalidopoulos (IT)
M. Kaizuka (JA)	
J. Mojarrad (MD)	
H. Beblawi (MI)	
	T. Manchev (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
M. Mouminah (SA)	
	K.Tan (ST)
P. Inderbinen (SZ)	
	R. Masood (UK), Temporary
M. Rosen (US)	

H. Al-Atrash, Acting Secretary
H. Malothra, Summing Up Officer
D. Jiang, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: C. DeLong, C. El Khoury. Middle East and Central Asia Department: A. Alreshan, J. Azour, N. Ben Ltaifa, T. Callen, J. Kahkonen, D. Kirti, I. Lukonga, V. Stepanyan, Y. Yang, T. Zhang. Strategy, Policy, and Review Department: P. Koeva Brooks. Statistics Department: X. Zhao. Alternate Executive Director: R. Alkhareif (SA), S. Geadah (MI), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI),

B. Alhomaly (SA), A. Muslimin (ST), S. Keshava (SA), Z.Mohammed (BR), O. Odonye (AE), A. Tolstikov (RU), C. Williams (CO). Advisors to Executive Directors: W. Al Hafedh (SA), O. Bayar (EC), D. Fadhel (MI), I. Fragin (GR), G. Khurelbaatar (AP), R. Lopes Varela (AF), R. Makhammadiev (SZ), C. Moreno (AG), H. Mori (JA), A. Park (AP), F. Rawah (SA), N. Vaikla (NO), Y. Zhao (CC).

2. SAUDI ARABIA—2019 ARTICLE IV CONSULTATION

Mr. Mouminah and Mr. Alkhareif submitted the following statement:

On behalf of the authorities, we would like to thank Mr. Callen and his team for the insightful Article IV report and selected issues paper and constructive policy discussions during the Article IV mission.

The authorities broadly agree with the staff appraisal and reiterate their commitment to implement their reform agenda to further diversify the economy, promote private sector-led growth, create job opportunities, particularly for youth and women, strengthen fiscal sustainability and transparency, and enhance financial stability and development. We look forward to continuing the close engagement with the Fund, especially as the Kingdom of Saudi Arabia is implementing its wide-ranging socioeconomic reform agenda under Vision 2030. Indeed, Vision 2030 is built on three pillars – a vibrant society, a thriving economy and an ambitious nation – that draw on the country's intrinsic strengths to help the citizens realize their aspirations. The vision's strategic objectives continue to be carried on under various Vision Realization Programs (VRPs).

Recent Economic Developments and Outlook

Reforms are starting to yield positive outcomes, reflecting improved sentiment and investor confidence. Real GDP growth increased from -0.7 percent in 2017 to 2.2 percent in 2018 despite fiscal consolidation and the implementation of wide-ranging reforms. Notably, economic activity in the private sector is gradually picking up, improving from 0.1 percent in 2016 to 1.7 percent in 2018. In fact, the main Saudi stock market, Tadawul, was one of the top 5 performers in the world last year, rising by more than 8 percent. We expect this momentum to strengthen in the period ahead, particularly given the ongoing efforts to develop and deepen the Saudi market in line with best international practices. The Saudi bond market has also proved to be robust with huge oversubscription and tight pricing of all recent issuances, which is an indication of the strong global interest in Saudi sovereign bonds. Going forward, we expect further strengthening of the growth momentum this year and over the medium term, given the positive impact of various reforms. The impact of the expatriate levy on growth is likely to be minimal, as the pace of the sharp decline in the number of expatriates is not expected to continue beyond what was anticipated following the announcement of the Fiscal Balance Program (FBP).

Risks to the outlook are broadly balanced. Staff has highlighted that downside risks to oil prices and production could materialize if global trade tensions result in a sharp slowing in global oil demand. In this regard, we are cognizant of such risks and reaffirm our support to strengthen the rules-based multilateral trading system. In addition, Saudi Arabia will continue to play its longstanding role in the global economy to help ensure sustainable global economic growth. To this end, it remains committed to support the stability of global oil markets for the benefit of both producers and consumers.

Fiscal Sustainability and Transparency

Fiscal position continues to improve significantly. While oil revenue has increased, the authorities' sustained efforts toward the rationalization of subsidies, streamlining of government spending, and promoting diversified and sustainable revenue base have contributed to a steady decline in the deficit. This was underpinned by the successful introduction of VAT in 2018 with revenue exceeding expectations, along with the new revenue streams from excises, expatriate levy, and proceeds from the settlement agreements. Non-oil revenue registered an increase from 10.2 percent of non-oil GDP in 2017 to 15.3 percent of non-oil GDP in 2018. On the expenditure side, efforts have continued to streamline both operational and capital spending. Indeed, the government is identifying cost savings and better allocating funds to viable investment projects through its Spending Efficiency Realization Center (SERC). The SERC is also playing an important role in enhancing fiscal planning to ensure that government agencies adhere to the budgetary expenditure ceilings. In this context, the authorities have successfully managed to lower the fiscal deficit from 17.2 percent of GDP in 2016 to 5.9 percent of GDP in 2018, which is lower than what was envisaged in the 2018 Budget. This confirms the authorities' discipline in maintaining sound fiscal policy with strong buffers.

Fiscal targets are expected to be met over the medium term, irrespective of the future path of oil prices. It is to be noted that higher oil revenues over the past two years provided more room for additional priority spending to promote growth and job creation, while preserving the fiscal balance objective over the medium term. On the same note, we view staff projection of oil prices as pessimistic. In addition, it is not reasonable that staff projections maintain both declining oil revenue and increasing expenditure paths simultaneously over the medium term. This gives an overly pessimistic and highly unlikely fiscal path. Notably, staff assume that government deposits at the Saudi Arabian Monetary Authority (SAMA) will be depleted by 2022, which is not realistic. To help achieve their fiscal targets, the authorities have additional policy levers that can be used if needed, such as implementing additional revenue measures, receiving higher dividends from the entities in which they have equity stakes, spreading out expenditure of some projects over a longer period, and postponing the non-priority planned spending to later years, while being mindful of the growth impact.

The authorities remain firmly committed to balancing the budget in 2023. In addition to the existing non-oil revenue measures, they plan to expand the base of excise taxes to cover sugar-sweetened beverages and e-cigarettes by the end of this year. In addition, energy price reform will continue to be implemented over the medium term, as announced in the FBP, while further strengthening social safety nets to ensure adequate protection for the eligible segments of the population.

The first quarter of 2019 registered the first fiscal surplus since 2014, as a result of strong revenue performance, despite a slight increase in expenditure, including to fund various reform programs. Here, it is worth mentioning that non-oil revenues increased by 46 percent compared to the first quarter of 2018, reflecting sustained fiscal reform efforts.

Significant reforms have been implemented to upgrade fiscal policies and public financial management, including the digitization of the budget process. In this regard, a new public procurement law was recently approved by Shura Council and will come into effect soon. The new law stipulates that purchases of commonly used goods across government bodies be coordinated through a Strategic Procurement Unit (SPU), which would also ensure that contracts are fulfilled at competitive prices. This would play an important role not only in enhancing spending efficiency and shortening the procurement cycle, but also in improving governance and accountability, including through strengthening and modernizing the procurement process and its oversight function. In addition, the successful launch of “Etimad” portal has reinforced controls and monitoring of spending, avoid recurrence of arrears, and further enhance transparency.

Fiscal transparency continues to improve. This includes the publication of the recent pre-budget statement and Aramco bond prospectus. Going forward, a midyear budget update will be published for the first time this year and progress in this area will continue.

Important progress has been made in developing a debt management framework. Close coordination among government entities on borrowing decisions is ongoing under the auspices of the Debt Management Office

(DMO) at the Ministry of Finance. In addition, borrowing and investment decisions of the government and semi-government entities are currently being coordinated by the Finance Committee. In addition, with a low level of public debt, important progress has been made in diversifying the sources of financing for the budget as well as the investor base, as evident by the recent announcement to tap into the euro market through the issuance of euro-denominated bonds for the first time (3 billion euro) in tranches of eight and twenty years.

Financial Sector Stability and Development

The banking sector remains sound and well-positioned to withstand shocks. With capital adequacy ratio exceeding 20 percent and return on equity (ROE) around 14 percent by end-2018, the banking sector remains adequately capitalized, profitable, and liquid. NPLs remain low at only 2 percent at end-2018 and total provisioning to gross NPLs has further increased to 157 percent. Credit growth has been healthy to support private sector activity. While banks' exposure to mortgage loans is limited at this stage, developments in the real estate market will continue to be monitored and addressed, if needed, to mitigate associated risks. Here, while LTV has been increased, it is complemented by the use of Debt Burden ratio (DBR). Also, risks are mitigated by direct salary deduction for the mortgage payment as well as the provision of mortgage loan government guarantee that depends on salary and number of family members. By end-2018, the revised banks' licensing requirements and guidelines framework were approved and the entry of five foreign banks, since 2018, is expected to boost competition in the banking sector further.

Important progress towards more open and dynamic capital market has started to yield positive results. In particular, the inclusion of Tadawul in major international indices such as FTSE Russell, S&P Dow Jones, and MSCI has resulted in a notable increase in foreign investment in the Saudi stock market and in enhancing investor sentiment, as reflected in improved equity valuation (more than 13 percent YTD). Recently, the Capital Market Authority has removed the cap on ownership for foreign strategic investors in shares of listed companies. This would allow international investors to take controlling stakes in Saudi listed companies. Also, the Saudi stock exchange has begun trading local-currency government bonds sold through a newly established "primary dealer" system. The increase in public issuances of debt instruments in the domestic market has contributed notably to strengthening governance, diversifying investment opportunities, and deepening and broadening the local capital market.

The implementation of the Financial Sector Development Program (FSDP) is progressing well. Here, the focus remains on developing a diversified financial sector, and supporting investment. SAMA also continues to promote digital banking and Fintech products to further develop the financial sector. Also, to achieve the Vision 2030 objectives, the FSDP recognizes the importance of incentivizing citizens towards savings. In this regard, a Kingdom-wide financial literacy program is ongoing to expand the financial knowledge of both current and future generations.

We are committed to ensure that a robust AML/CFT framework is in place. Recently, Saudi Arabia became the first Arab country to obtain a full membership of FATF. It endorses and reaffirms the role of FATF in fighting ML/FT and welcomes the adoption of UNSC Resolution 2462 related to criminalizing financing of terrorists as an international law.

The external sector has continued to improve, and international reserves remain at a comfortable level. Notably, the current account remained in the positive territory for the second year in a row and has increased significantly by around 7.7 percentage points by end-2018. Over the same period, reserves remained adequate and accounted for 26.7 months of imports. Given the structure of the Saudi economy, the exchange rate peg continues to serve the economy well.

Structural Reforms to Support Diversification, Job Creation and Women Empowerment

The authorities are determined to achieve their economic diversification objectives and further enhance the role of the private sector in growth and job creation. The recently launched National Industrial Development and Logistics Program (NIDLP), and the various giga-projects, including NEOM, Red Sea, Amaala, and Qiddiya, will help bolster foreign direct investments and bring growth opportunity and infrastructure to key sectors such as construction, tourism, manufacturing, mining, energy and logistics.

Significant investments are being made in ports, railways, roads, and airports with the aim to develop a logistics gateway between Asia, Africa, and Europe. In this context, the Public Investment Fund (PIF) will continue to play a catalytic and complementary role to the private sector. While it aims to invest in new promising sectors, it will be a key driver to enable private sector participation, create jobs, and support capability development in those sectors.

Key reforms have been implemented to enhance the role of the private sector. In addition to the launch of the private sector stimulus package, the authorities have been engaging with the private sector in addressing remaining challenges. To this end, important progress has been made in improving the business environment and facilitating access to finance, especially for SMEs. Some major reforms were implemented, including:

Governance and legal reforms: the introduction of the new Insolvency Law as well as the updated Competition Law and Public-Private Partnerships Law will promote private sector development.

Improvement in government services through digitalization: this includes “Meras”, which is a unified online platform to streamline services to businesses from different government entities. Also, “Fasah” was created to facilitate trade and accelerate custom clearance process.

Promoting SME growth remains a priority, with ongoing efforts to implement a new funding strategy to address funding gaps and cater to SMEs in different stages in different forms.

Attracting skillful foreign workers: a new visa and residency program for skilled foreign workers and investors was approved by the Council of Ministers. The Premium Residency scheme offers two types of residencies, permanent and a one-year renewable residency. This will provide foreign workers with more mobility within the labor market, and an opportunity to invest in Saudi Arabia with little to no restrictions.

New initiatives have been taken to encourage tourism-related investment. We expect the demand for entertainment and tourism sector to increase over the medium term, mainly due to the major ongoing visa and residency reforms, which has been rolled out starting mid-2019, and the investments in tourism projects and entertainment activities. A tourism visa legislation is under consideration, replacing the current system that requires visitors to request event-specific visas. The new e-visa will be available to a wide range of nationalities this year, while the process will be automated. It is worth mentioning that tourism sector, while new, is growing gradually and is expected to contribute positively to GDP growth going forward.

Efforts continue to focus on increasing female labor force participation and empowering women. This remains a key priority for the authorities. Female labor force participation has continued to rise, partly due to the efforts to promote female entrepreneurship, transportation, and childcare assistance programs. Empowering women in the private businesses and raising their SME ownership was strengthened by the launch of the “Women in Business” initiative. It allows beneficiaries to participate in programs that contribute to building the potential of women in business and facilitating effective communication with experts and specialists as well as exchange experiences, information, ideas and guidance. The Ministry of Labor and Social Development (MLSD) announced 68 new initiatives to stimulate Saudization in the private sector, including offering training programs and additional supporting measures for females. Needless to say, allowing women to drive since last year has helped enable them to join the labor force.

Affordable housing is essential to enhance inclusive growth. The authorities launched the new housing program as the Kingdom seeks to boost Saudi ownership of homes from 47 percent to 70 percent by 2030. The program offers loan-guarantees and supports down payments and is expected to expand the mortgage market substantially through increased private-sector participation. As mentioned above, the authorities will remain vigilant about the associated risks. In fact, measures to mitigate potential risks are already in place.

Ensuring a robust public governance and anti-corruption system is a priority. The authorities are determined to press ahead with the implementation of their anti-corruption strategy and have reiterated their emphasis on having a “zero tolerance for all levels of corruption”. They recently amended the anti-bribery law and enabled the Public Prosecutor and Nazaha to detect, investigate and prosecute corruption-related offenses. Decisions on corruption cases resulting in a conviction or acquittal exceeds 700 cases over the last 8 years.

Further improving the quality and availability of data is a key objective. In this context, the authorities have been reporting its quarterly budgetary central and general government debt data in the Quarterly Public Sector Debt Statistics (QPSDS) database since Q1 2017 and are determined to subscribe to the SDDS before the end of this year.

Conclusion

Finally, the authorities continue to value the constructive recommendations by the Fund and they look forward to continuing their strong Fund engagement. As highlighted in the staff report, many of recommendations laid out in the 2018 Article IV report and 2017 FSSA reports were appropriately addressed. Going forward, the authorities will continue to take into consideration staff's recommendations as they continue the implementation of their socioeconomic reforms.

Mr. De Lannoy, Mr. Doornbosch and Mr. Manchev submitted the following statement:

We thank staff for the comprehensive set of papers and Messrs. Mouminah and Alkhareif for his informative buff statement. The earlier reforms have already yielded encouraging results. Growth has rebounded, unemployment among the Saudi nationals has declined, non-oil growth is expected to further strengthen in the medium-term and risks to the outlook remain broadly balanced. We commend the authorities' Vision 2030 aiming to diversify the economy away from oil and employ more women in the labor force. The high geopolitical tension in the region, increased trade risks, and large uncertainty and volatility of oil prices require careful' consideration going forward.

Fiscal Policy and Public Finance Management

We welcome the authorities' commitment to balancing the budget in 2023 and their readiness to consider offsetting measures. The government should closely link spending policies to proper responses from the private sector to guarantee the economic diversification and sustainable long-term development. Thus, further strengthening of the country's medium-term fiscal framework and policy analysis and increasing budget transparency will be critical to better identify the cyclical fiscal position and timely policy responses. The already announced fiscal measures, even if fully implemented, may fall short to achieve the authorities' medium-term budgetary objectives. In this regard, staff's initial assessment of the fiscal and economic impact of the sustainable non-oil revenue reforms in the SIPs provides a solid ground for the authorities' policies.

Further improvements of the fiscal transparency and governance are welcome to bring Saudi Arabia's disclosure and public financial management in line with the best-recommended international practices. As it has been well-reasoned in Box 3 (p.18 of the report), the institutional coverage of fiscal reporting should be broadened to include operations of the sovereign wealth funds and national oil companies and the legal framework should be strengthened to bring their governance arrangements and operational rules in line with the IMF Fiscal transparency Code. A comprehensive law is needed to formalize all phases of the budgetary process of the consolidated public sector, codify documentation and reporting requirements, and institutionalize the external audit arrangements. The new public procurement law and reforms to the process should ensure coverage of all government procurement to help strengthen spending efficiency and reduce corruption risk. We also underscore the need for Saudi Arabia to increase transparency of the debt management and develop an integrated public asset-liability framework.

Financial Stability and Inclusion

We welcome Saudi Arabia's inclusion in the global equity and bond market indices. The authorities continue to strengthen the supervisory framework and implement the macroprudential policy framework. These, together with the next steps of their Financial Sector Development Program should improve financial access, inclusion and the SMEs financing. Saudi banks have been progressing well with measures to preserve their corresponding banking relations under the enhanced AML/CFT global regulation and we encourage the authorities to address the remaining issues identified in the recent mutual evaluation report. However, staff's analysis in Box 7 (p.28 of the report) provides reasonable arguments that common ownership of banks may reduce competition and charge higher prices, but we would suggest a more in-depth analysis going forward. Although the banking sector seems well-positioned to weather asset quality and liquidity shocks, more vigilance is needed to the housing market development given the strong mortgage lending and potential fiscal spillovers in an environment of declining real-estate prices.

Structural Reforms

We acknowledge that a broad range of government policies have already been initiated under the Vision 2030 to diversify the Saudi economy. Staff's analysis signals that the recent increase in the government spending cannot entirely compensate for the delayed private sector response. In this respect we welcome staff's suggestions for a well-sequenced approach to the labor market reform, accompanied by the next steps to reduce barriers to doing business, and to enhance the role of the SMEs and entrepreneurship to mitigate risks of the painful economic adjustments. Could staff give an update on the authorities' progress to adopt and implement new laws on competition, franchise and insolvency, as well as on implementation of the anti-corruption measures and their near- and long-term growth effects?

Finally, we welcome staff's continuous focus on statistical issues and the intensive TA provisioning and encourage the authorities to promptly subscribe to the IMF Special Data Dissemination Standard.

Mr. Kaizuka and Ms. Mori submitted the following statement:

We thank staff for the comprehensive reports and Mr. Mouminah and Mr. Alkhareif for their informative statement. We are pleased to see that wide-ranging socioeconomic reform agenda under various Vision Realization Programs are moving from design to implementation phase and reforms are starting to yield positive results with growth accelerating, female participation rates increasing, and non-oil budget revenues increasing. That being said, key challenges such as promoting non-oil growth and creating jobs for Saudi nationals remain and we encourage the authorities' continuous efforts. As we broadly concur with the thrust of staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

Fiscal consolidation is needed to reduce fiscal vulnerabilities stemming from an oil price volatility and create additional fiscal space. It is commendable that the authorities have been implementing fiscal reforms including introduction of VAT, quarterly gasoline prices adjustment, and increasing fiscal transparency. We also positively note that 2019 Q1 registered the first fiscal surplus since 2014 and that non-oil revenues increased by 46 percent compared to 2108 Q1. However, more efforts are needed to reduce procyclicality of government spending and achieve a balanced budget in 2023. Noting the authorities' commitment to balancing the budget in 2023, we encourage the authorities to implement fiscal measures while providing social safeguard to mitigate the impact of reform on the poor. In the meantime, we note the significant difference of fiscal projections between staff and authorities. The authorities insist in their buff statement that staff projection of oil prices is too pessimistic, and it is not realistic that staff projections maintain declining oil revenue and increasing expenditure paths simultaneously over the medium term. In this regard, we would like to ask staff's view on the authorities' oil price projection and whether the authorities have any fiscal rules or legislations that ensure the spending restraint in case of lower than expected oil prices to achieve fiscal target.

We welcome that progress has been made in strengthening the fiscal framework and fiscal transparency including approval of new public procurement law, introduction of online expenditure management system and planned publication of a midyear budget update. We encourage the authorities to improve transparency of the Public Investment Fund (PIF). We agree with staff that the fiscal framework and expenditure management process need to maintain spending at a level that is sustainable across different oil price environment to avoid large adjustments in spending during times of low oil prices.

Financial Sector

We welcome that the banking system is well capitalized and liquid, and the rapidly growing mortgage lending are carefully monitored. On the NPL, which edged up to 2 percent in 2018 Q4 though the ratio remains low, could staff elaborate on the cause of the increase and whether there are specific sectors that the NPL is increasing? We also welcome the efforts under the Financial Sector Development Program aiming at diversifying financial sector and supporting investment. On the capital market reforms, publication of an Annual Borrowing Plan and issuance calendar for domestic debt, establishment of the primary dealer system, inclusion in global equity and bond market indices, and removal of the cap on ownership for foreign strategic investors in shares of listed companies are welcoming steps. On the primary dealer system, we would like to ask whether foreign institution can be a primary dealer, which would help internationalization of the bond market. As stated in the buff statement, we expect the increase in public issuances of debt instruments would help strengthen governance, diversify investment opportunities, and deepen and broaden the local capital market.

Structural Reforms

Reforms should be implemented in a manner to crowd in private sector, diversify the economy, accelerate job creation and improve productivity performance. We welcome that the unemployment rate of nationals has declined, and female labor participation rate has continued to increase. We agree with staff that strengthening human capital to raise productivity and provide workers with the skills needed in the private sector will be essential to success. We acknowledge the authorities' plan to boost the productivity of Saudi workers including by strengthening education and training and encourage their continuous efforts. On the involvement of private sectors, could staff elaborate more on how the authorities' industrial policies incentivize private companies to enter new or riskier sectors and the role of PIF in this context? On the economic diversification, which we believe a key of the country's growth, we appreciate the explanation in the buff statement of new initiatives on tourism sectors and encourage the authorities to develop similar kind of initiatives in other priority areas. In this regard, we would like to hear staff's view on promising sectors of the country?

Mr. Merk and Mr. Fragin submitted the following statement:

We thank staff for the informative set of reports, and Mr. Mouminah and Mr. Alkhareif for their helpful buff statement.

We broadly concur with staff's assessment. The Saudi Arabian economy has grown at 2.2 percent in 2018, thus recovering well from a slight decline in the previous year. The uptick can be mainly attributed to rising oil prices which increased oil GDP by 2.8 percent as opposed to -3.1 percent in 2017. Non-oil GDP continued to grow moderately. The authorities have continued fiscal consolidation as well as their reform agenda to diversify the economy and reduce dependence on oil exports. Despite the favourable outlook for oil prices in the coming year with the assumed recent OPEC+ agreement, further efforts in fostering private business activity, streamlining government spending, and improving the governance framework are warranted. Striking the right balance between fiscal consolidation and supporting private sector growth will be crucial in reducing medium-term vulnerabilities and preparing the country for a possible slowing in global oil demand.

We encourage the authorities to continue streamlining government spending, thus building buffers to shield against large swings in oil prices. Increased government spending in 2018 has increased vulnerabilities in this regard. We therefore concur with staff's recommendation to further tighten fiscal policy by reducing the public wage bill, phase out subsidies and allowances, and execute public investment in a more targeted manner. At the same time, the less well-off parts of the population should be protected from cuts in public spending.

We further support staff in their recommendation to use more conservative metrics such as the Non-Export Oil Primary Deficit as a benchmark for public expenditure management. In times of high oil prices using such a metric could help to build fiscal buffers and reduce fiscal vulnerabilities. Increasing fiscal transparency could further contribute to maintaining budgetary discipline.

Given the still moderate growth in the non-oil sector, further emphasis should be placed on spurring the currently negative productivity growth and strengthening competitiveness. We therefore support staff in their call for further diversification efforts away from the public sector. In light of high youth unemployment and low female labour market participation rates, the authorities could take further measures to increase the attractiveness of the private sector for workers. In this context, we also support staff in their call for more investment in training and education.

We commend the authorities for the steps taken to enhance the governance and anti-corruption frameworks. We also agree with staff that further efforts, including introducing financial disclosure policies for senior public officials and strengthening the AML/CFT framework, appear warranted and could also be helpful to attract FDI and foster private sector growth.

We support staff's recommendation to introduce the IMF's Special Data Dissemination Standard as soon as possible to improve the availability and quality of economic data.

Finally, we strongly encourage the authorities to consent to the publication of the staff report.

Mr. Gokarn, Mr. Tan, Mr. Siriwardana, and Mr. Anwar submitted the following joint statement:

We thank staff for the comprehensive reports. We also thank Mr. Mouminah and Mr. Alkhareif for the informative buff statement. We commend the authorities for the substantial progress in implementing their reform agenda. We take positive note that reforms are starting to yield positive results. Inter alia, the real GDP growth rebounded in 2018, female labor participation and employment have continued to increase, the fiscal deficit has narrowed, non-oil growth has picked up. Looking ahead, risks in the near-term are broadly balanced while growth is expected to pick-up over the medium-term and inflation continues to decline in 2019 before turning positive in 2020. Against this backdrop, we encourage the authorities to remain focus on balancing the budget in 2023 and structural reforms to support diversification, job creation, and inclusive growth. We concur with the broad thrust of the staff appraisal and offer the following comments for emphasis.

Fiscal policy should remain focused on achieving fiscal sustainability in the medium-term. We welcome the authorities' fiscal consolidation efforts that resulted in a steady decline in deficit since 2016. We agree with the buff statement that these actions have brought positive results in a growth-friendly manner to the country. Could staff elaborate how the suggested additional fiscal measures would support stronger growth over the medium-term? The fiscal consolidation process is far from over and we support the authorities' strong commitment to achieve fiscal balance in 2023. In this light, while we welcome the authorities' continued reform in energy price over the medium-term, we encourage the authorities to continue their regular assessment of the effectiveness of the Citizens' Account program and strengthening of their social safety nets to ensure adequate protection for the most vulnerable segments of the population. We note the authorities' concern with staff's fiscal outlook. Staff's comments are welcome on the budget surplus in 2019Q1, the additional policy levers at the authorities' disposal, and the substantial financial assets available beyond the budgetary central government.

We welcome the authorities' strong focus on growth and employment enhancing reforms. Like staff, we see the importance of economic diversification to the non-oil sector with improved cost competitiveness to sustain inclusive growth and create jobs. Hence, we welcome the authorities' efforts toward the comprehensive Vision 2030 and note positively the broad agreement with staff on advancing reforms in improving the business environment, developing new economic sectors and strengthening human capital of Saudi nationals. The Selected Issues Paper is instructive, including the key takeaway that a pre-requisite to successful diversification is equipping Saudis with the right skills and incentives to offer them at competitive wages. The recent measures to improve female labor force participation are reassuring and we encourage the authorities to follow through on staff's recommendations to expedite this process. Continuing efforts are also important to enhance governance and legal framework.

A well developed and inclusive financial sector is essential to safeguard financial system stability. We take positive note that banks are profitable, liquid, and well capitalized. While mortgage lending is growing strongly against the backdrop of declining real estate prices, we encourage the authorities to continue keeping a careful eye on the quality of real estate lending. We welcome the progress made on the recently adopted Financial Sector Development Program (FSDP) to increase financial inclusion and bank lending to SMEs. We are also pleased with the encouraging milestone in the development of the capital market. We invite staff to comment on the impact of the introduction of a primary dealer system and the extension of the government yield curve to long-dated maturities to increase private sector investments and activities in domestic debt market.

Sound monetary policy supports macroeconomic stability. We welcome the recent SAMA's monetary policy stance to achieve price stability. We take positive note that a liquidity forecasting model has been developed, tested, and presented to the monetary policy committee. We would like staff to comment on the effectiveness of the established liquidity-forecasting framework to guide money market operations and maintain monetary stability.

Given the structure of the economy, we agree with staff and the authorities that the exchange rate peg has served Saudi Arabia well and it remains the best exchange rate option for the country at the current juncture.

With these remarks, we wish the authorities continued success in their endeavors.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for their report and two insightful selected issues papers, as well as Mr. Mouminah and Mr. Alkhareif for their comprehensive buff statement. The authorities are making good progress on their reform agenda, which is starting to bear fruits. While oil remains predominant in the economy and as a share of public resources, non-oil growth is picking up. Further reforms should aim at reducing medium term fiscal vulnerabilities, and at fostering the structural conditions for a successful diversification. We share the thrust of staff analysis and recommendations and wish to share the following comments.

While debt remains limited and the authorities have significant buffers, efforts should continue to reduce the procyclicality of government spending and to enhance public finance management, efficiency and transparency. We commend the authorities for the ambitious non-oil revenue reform of 2018, which will generate 10,7 percent of GDP of additional revenue in 2024. This is a structural and potentially transformation step that has been taken. While staff is cautious on the limited magnitude of the consolidation trajectory over the medium term, it is reassuring to the authorities' signal that they will adapt their fiscal policy if the oil price forecast is not met. In particular, we note that Mr. Mouminah and Mr. Alkhareif insist in their buff that it would be very unlikely that expenditure would be increased in a context of declining oil revenues. Could staff elaborate on the assumptions underlying those medium-term projections and how they compare with the authorities' intentions? Moving forward, containing the significant wage bill could be a useful way to bring down the deficit while addressing what is currently a challenge for the private sector competitiveness. Efficiency of government spending (both current and capital spending) should also continue to be strengthened. Procyclicality of government spending should also be reduced, in line with past efforts to strengthen the multiyear budgeting and expenditure processes. Placing a greater emphasis on the non-exported oil primary deficit has the potential to limit volatility in spending and rebuild buffers. Finally, we note the positive steps taken to enhance fiscal transparency, and encourage authorities to further their efforts, for instance on the structure of the PIF's assets.

The external position, which is moderately weaker than consistent with desirable medium-term settings, should be strengthened by a gradual fiscal consolidation over the medium term. We share staff assessment that the peg remains the best exchange rate option for Saudi Arabia given the current structure of the economy. We note that banks appear well positioned to weather asset quality and liquidity shocks, but that particular attention should be paid to the expansion of mortgage lending, at a time when housing prices are coming down. We encourage the authorities to closely monitor these developments. In this regard, a useful way to assess vulnerabilities in the housing market could be to assess the overvaluation of real estate assets, as was done for the 2019 Canada Article IV report for specific local markets. Rapid development of the capital markets, in line with past staff recommendations, are commendable. Given the limited share of SME loans in total lending, as evidenced in figure 11, does staff estimate that there is a financial inclusion issue in Saudi Arabia (regarding SMEs or new firms)? Finally, we commend Saudi Arabia for its recent membership to the FATF and encourage the authorities to continue to implement their national strategy against money laundering and terrorism financing.

Efforts to diversify the economy are starting to bear fruits, and more structural reforms will be needed to support inclusive growth and job creation. The selected issues paper on policies to drive diversification was an interesting input to this discussion. It clearly outlines the need to address high government wages, to support cost competitiveness, and to enhance human capital. Developments on industrial policies were particularly welcome, as they show how policies can be instrumental in fostering specific clusters of activity, while ensuring that recipients remain accountable. Ensuring stronger inclusion is also necessary. We encourage the authorities to review the regulatory framework to ensure that there are no impediments to female employment and entrepreneurship; we note in particular that Saudi Arabia ranks last in the World Bank's Women, Business and the Law index. We would welcome staff comments on possible future reform initiatives in this regard. Regarding the Saudization strategy in the job market, we would welcome staff comments on their costs and benefits, with sizable fiscal revenues, but possible detrimental impacts on the operations of businesses. Continued effort will be needed to enhance the effectiveness of the anti-corruption framework, building on the good progress achieved over the last few years. Finally, we welcome efforts to enhance the business environment and ensure effective competition, and encourage authorities to continue their efforts over the medium term.

Mr. Kaya and Mr. Bayar submitted the following statement:

We thank staff for their comprehensive set of reports and Messrs. Mouminah, and Alkhareif for their insightful buff statement. The Saudi authorities are taking important strides in implementing their reform agenda including toward further diversification of the economy, enhancing public financial management, leveraging private sector momentum, and promoting youth and female employment. Improved business sentiment buoys non-oil growth and risks to the outlook are broadly balanced. We therefore see this as an opportune time to further advance the authorities' Vision 2030, while at the same time building fiscal buffers and reducing medium-term vulnerabilities. We agree with the thrust of the staff appraisal and would like to add the following comments for emphasis.

Further fiscal effort is needed to secure the authorities' medium-term balanced budget target. We welcome the impressive growth of non-oil revenues (i.e. 59 percent year-on-year) in 2018 on the back of the introduction of the VAT as well as the new revenue streams from excises, expatriate levy, and the one-off proceeds from the settlement agreements. We also take positive note of the gradual rationalization of electricity and gasoline subsidies and expect that future efforts should be geared toward adjusting water prices to cost-recovery levels. We appreciate that the authorities have put in place mechanisms to support the poorer segments of the population vis-à-vis increases in taxes and utility prices. Nevertheless, we agree that a better targeting in social assistance programs could be achieved to ensure that these programs are fit-for-purpose and executed in a fiscally-efficient manner. On the expenditures, we note that the authorities stand ready to take measures in case the oil revenues surprise on the downside, which along with other measures, could help balance the budget by 2023. While such a policy stance could make staff's medium-term fiscal projections look somewhat pessimistic, it also aggravates the concerns about the procyclicality of fiscal policies. On this note, we agree with staff that containing expenditures, particularly the current spending, would help de-link the fiscal policy from oil price oscillations, address medium-term vulnerabilities, and better serve inter-generational equity. Could staff elaborate on the budget flexibility in Saudi Arabia, particularly with respect to the extent to which planned expenditures can be postponed or cancelled?

We welcome the significant improvements in public financial management, including through strengthening the budget processes, entrenching a medium-term fiscal perspective, and digitalization of the expenditure management system. We also commend the authorities for the progress in the fiscal transparency area and encourage them to strive for further improvements by publishing more detailed budget and spending execution data, and reconciliation of projections with outcomes. We appreciate the recent promulgation of the new public procurement law which should help enhance spending efficiency as well as improve governance and accountability. We concur with staff that the effectiveness of the new legislation critically hinges on its comprehensiveness and thus, encourage the authorities not to exempt any entities that use budget funds.

The exchange rate peg continues to serve the Saudi economy well. Notwithstanding possible advantages of a gradually more flexible exchange rate regime, we agree that a move away from the peg would unduly jeopardize the monetary anchor in Saudi Arabia and would have limited benefits for competitiveness in the short run. Nevertheless, in line with staff's assessment, we find it useful to regularly review the peg to ensure that it remains appropriate. Can staff elaborate on the optimal monetary policy stance in a hypothetical scenario where inflation dynamics between the U.S and Saudi Arabia diverge materially? Regarding the financial sector, we welcome that the banking sector has a broadly sound balance sheet and is well-positioned to withstand asset quality and liquidity shocks. As mortgage lending continues to expand rapidly against a backdrop of declining house prices, we underscore the importance of continued vigilance about possible financial and quasi-fiscal risks.

The far-reaching reform agenda needs to be prioritized to help achieve the Vision 2030 objectives. We welcome the authorities' emphasis on private sector development as well as staff's emphasis on this issue through their thematic analysis in the Selected Issues Paper. We agree that the impact of the authorities' reform endeavors could be compounded by (i) a carefully-devised industrial policy which entails well-targeted, structured, and sequenced measures to encourage specific clusters of innovative activity, and (ii) continued labor market reforms that inter alia emphasize human capital improvements, provide equal opportunities for youth and women, and ensure adequate incentives for employment outside the government. Throughout the implementation of these reforms, it is critical to contain the fiscal footprint.

Finally, we welcome the authorities’ plan to subscribe to the Special Data Dissemination Standard (SDDS) by year end as indicated in the buff statement.

Ms. Levonian, Ms. McKiernan and Mr. Williams submitted the following statement:

We thank staff for their comprehensive set of reports and Messrs. Mouminah and Alkhareif for their insightful buff statement. Saudi Arabia has reaped rich macroeconomic dividends from sound reforms under Vision 2030. Growth rebounded in 2018 and the fiscal deficit narrowed, enabling debt to remain moderate. Still, the country remains highly vulnerable to lower oil prices. Against this backdrop, the authorities are advised to accelerate reforms geared at diversifying the economy, boosting productivity, and attracting private investment. Complementary measures to improve the fiscal framework and preserve social protection are also needed to promote and sustain inclusive growth. We broadly concur with staff’s assessments and recommendations and offer the following remarks for emphasis.

We urge continued efforts toward fiscal consolidation while ensuring adequate social protection. Going forward, reduced reliance on oil revenues will be integral for fiscal sustainability. Like staff, we are concerned that the authorities’ plans to balance the budget by 2023 hinge prominently on high oil revenues. In addition to already announced measures, doubling the VAT rate to 10 percent, as suggested by staff, would reduce dependence on oil revenues and help to durably balance the budget. That said, the authorities’ identification of contingency measures is welcome, and they should stand ready to implement them, if required. We invite staff’s elaboration on the strength of such commitment. Relatedly, we encourage further actions to curb public wage costs including through a review of allowances and benefits under the ongoing civil service review. Mindful of the expected impact of the slate of fiscal measures, we support a consolidation and streamlining of social assistance programs that are well-targeted to vulnerable households.

Further improvements to public financial management and enhanced transparency are key to strengthening the fiscal framework. The new procurement law is a step in the right direction toward improving spending efficiency, promoting accountability, and reducing the risks of corruption. We encourage full implementation of the enhanced procurement process through the electronic expenditure management platform, Etimad. Additionally, the significance of the public investment fund (PIF) for advancing the authorities’ reform agenda - including economic diversification - underscores the importance of a transparent and robust asset-liability management framework to guide investment decisions. On data provision, we welcome the inaugural publication of a pre-budget statement in 2018, as well as Aramco's financial statements in its recent bond prospectus. At the same time, we echo staff's call for more detailed and broader coverage of fiscal information. In this context, we urge the authorities to stay on course toward subscription to the SDDS by end-2019.

Increasing the private sector's footprint in the economy will be integral to spurring higher and inclusive growth. There is significant scope to upscale the private sector's role in economic expansion and for fostering economic diversification. This will require, inter alia, implementation of measures to improve the business environment and enhance access to finance, particularly for small and medium-sized businesses. In this regard, actions taken to streamline FDI requirements and procedures for starting a business are steps in the right direction. So too are recent legislative reforms to enhance the governance framework, including by empowering the anti-corruption agencies to function effectively. Alongside the ongoing and planned enhancements to the fiscal framework, these measures should be complemented by reforms to incentivize workers toward the private sector.

We stress the importance of further efforts to enable a more efficient labor market and productive workforce. To this end, we support the authorities' focus on strengthening education and training and we agree with staff that companies should be encouraged to prioritize human capital development. Moreover, a curtailment of employment and wage growth in the public sector will help to shift the incentives toward private sector jobs. Relatedly, we take positive note of recent initiatives to increase female labor force participation, including lowering transportation and childcare costs. Nevertheless, we remain concerned about gender disparity, including with respect to employment opportunities and limited access to financial services for women. In this regard, we continue to stress that the authorities should ensure there are no barriers to female employment and entrepreneurship.

Mr. Heo and Mr. Khurelbaatar submitted the following statement:

We thank staff for the comprehensive report and Mr. Mouminah and Mr. Alkhareif for their helpful buff statement. The economy of Saudi Arabia is demonstrating good performance, growth outlook is broadly balanced, fiscal deficit is lowered, debt is low and external balance is in positive territory largely thanks to higher global oil prices. We commend the authorities for undertaking structural reforms to reduce macroeconomic vulnerabilities and develop the non-oil economy. We broadly concur with staff's assessment and have the following comments.

There was a considerable progress in developing the non-oil economy, improving business environment and reducing unemployment among women and youth. We welcome that the Saudi Arabian authorities incorporated most of the 2018 Article IV and 2017 FSAP recommendations into the country's economic reform policies. Saudi Arabia is highly dependent on the global oil prices and further efforts are needed to diversify the economy, avoid procyclical policies and reduce vulnerabilities of the economy. We also thank staff for the excellent set of analytical documents attached with the report, which provides detailed information about Saudi Arabia's economic sectors.

Fiscal consolidation is needed to build fiscal buffers and would strengthen Saudi Arabia's economic prospects. The risk assessment matrix done by staff highlights that Saudi Arabia is highly vulnerable to the global economic developments and to the progress of domestic reforms. Therefore, further fiscal adjustment would strengthen Saudi Arabia's current economic position and would enable the country to face future economic challenges with greater certainty. The introduction of VAT, energy and water price reforms, more targeted social expenditure and increased efficiency of capital spending will strengthen Saudi Arabia's fiscal position. The new public procurement law will be an important reform which could enable greater efficiency and transparency of public spending.

We took note of staff's view that the departure of expatriate workers and their dependents could have a larger impact on growth in the short term and agree that the increase in labor fees (levy) should be phased-in gradually over 2020-2022 to mitigate the impact on business and the economy through consumption and the housing market.

We share staff's view that incentives for private sector employment of Saudis should be improved and barriers to diversification would be difficult to overcome without addressing the productivity-wage gap. In this context, we welcome staff's elaboration on how wage subsidies for Saudis might fit within a sustainable fiscal envelop if combined with other fiscal reforms, as suggested in the selected issues paper (p12)?

A broad range of policies under Vision 2030 to diversify the economy has begun to pay off. Non-oil sector is growing, employment and most notably female employment has increased. Reforms towards ease of doing business, rule of law, SME development and improving productivity of Saudi labor force should continue to support the growth of non-oil sectors.

Further improvement of quality and availability of data is needed. In particular, data on poverty and official poverty line needs to be published for better monitoring and evaluating pro-poor policies, as highlighted in Box 2. Data of the PIF's operation is also limited. We agree with staff that the information on the structure of the PIF's assets would enhance the accuracy of staff's estimates of appropriate fiscal buffers as a whole.

We welcome staff's elaboration on the current situation of NEOM project and its possible impact on fiscal viability?

With these remarks, we wish the Saudi Arabian authorities every success in their future endeavors.

Mr. Tombini and Ms. Mohammed submitted the following statement:

We thank staff for an informative set of reports and Messrs. Mouminah and Alkhareif for their helpful statement. Saudi Arabia continues to be impacted by volatile international oil prices, which leads to heighten macroeconomic vulnerabilities. Although most macroeconomic indicators have weakened, Saudi's sizeable buffers have helped cushion the recent oil price decline. Nevertheless, we commend the authorities for their ongoing commitment to fiscal adjustment and diversification via the Vision 2030 reform agenda, which have the potential to transform the Saudi economy and sharply reduce its oil dependence.

Fiscal consolidation is needed to rebuild fiscal buffers and reduce medium-term vulnerabilities. The authorities are to be commended for their progress with fiscal reforms, in particular the introduction of VAT and energy price reforms, which helped reduce per capita consumption of gasoline and electricity. We also welcome the review of social assistance programs and the new public procurement law aimed at improving efficiency and good governance. Nonetheless, we agree with staff that there needs to be a balance between fiscal sustainability and social and development spending. Priority should be given to reducing the government wage bill and to implementing a more measured increase in capital spending, and we encourage the authorities to adopt a fiscal policy anchored in a medium-term framework. We note the disagreement between staff and authorities on the fiscal outlook, which is mainly due to the assumptions on oil prices. Can staff further discuss the factors behind the divergence in oil price assumptions and the impact on the fiscal outturns going forward?

Financial stability needs to be preserved. Saudi Arabian banks remain profitable, liquid and well-capitalized. However, against the backdrop of declining house prices, mortgage lending is expanding robustly and warrants close monitoring. We take note that although banks' exposure to real estate is limited, large housing price movements may trigger financial instability. Like staff, we welcome the improved access to financial services under the Financial Sector Development Program (FSDP). While we agree that the development of Fintech and agency banking would help to develop a more dynamic financial sector by broadening access to financial services and increasing market competition, it should be complemented by appropriate safeguards to financial stability. The developments in the domestic debt market with the introduction of a primary dealer system and the extension of the government yield curve to long-dated maturities are welcome. Moreover, we commend the authorities for their efforts in strengthening the AML/CFT framework in line with the FATF/MENAFATF mutual evaluation and encourage them to continue to address the issues raised in the report, including due diligence of politically exposed persons and pursuing financial investigations.

We welcome the authorities' structural reform agenda to diversify the economy while supporting inclusive growth and job creation. The authorities' continued efforts to improve the business environment, develop new sectors, and strengthen human capital would help the diversification effort. We recognize that without addressing the productivity-wage gap among nationals, barriers to diversification will be difficult to overcome. Nevertheless, we take note of labor market reform elements suggested by staff as outlined in the report. Further, we underscore the importance of increasing labor force participation of women, including creating programs for female entrepreneurs and expanding existing programs to help with transportation and childcare costs. Staff comments on the progress with these policies to increase female labor force participation since the last Article IV report would be appreciated.

Mr. Psalidopoulos and Mr. Persico submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Mouminah and Mr. Alkhareif for their informative buff statement. We support the staff's appraisal and would like to provide the following comments.

The economic rebound, since the recent decline, provides a window of opportunity for ambitious reforms, industrial diversification, fiscal stabilization and inclusive growth.

We invite the authorities to take advantage of the current positive performance to timely deliver envisaged action on these fields as embodied in the Vision 2030 agenda and its Realization Programs. Considering the downside risks related with oil production and global trade tensions, we welcome the authorities support to strengthen multilateral trading system and oil prices stability.

We praise the authorities for having significantly narrowed the fiscal deficit through balanced increase on both oil and non-oil revenues. Nonetheless, it remains higher than desirable, calling for a gradual fiscal adjustment. We note that staff and authorities have different views on the fiscal balance objective over the medium term. In this regard, we share the authorities' concerns (as referred in the buff statement) over pessimistic projections and the related assumptions on simultaneous declining oil revenues and increasing expenditures. Ongoing improvements in fiscal transparency and public governance are welcome. We invite authorities to continue their efforts to broaden fiscal reporting, in particular for the Public Investment Fund Program and Aramco, as well as to improve public spending efficiency.

Ongoing efforts to increase non-oil revenues are welcome, but the authorities should avoid measures hindering private-led growth. Envisaged measures will permit to reduce both the fiscal deficit and the dependence of revenues from oil production. However, we share staff advice (as well described in the SIP) to adopt a gradual approach on expatriate labor fees and taxes on tourism and entertainment in order to not adversely affect private-sector development and future job creation. Moreover, the new fiscal actions should be always complemented by timely implemented social safety measures to protect the most vulnerable. In addition, we invite the authorities to reduce spending procyclicality improving both budget management and medium-term spending strategy.

Diversification remains a key element for long-term growth and macroeconomic stability. In this regard, we welcome the SIP on this topic and invite the authorities to follow its main policy advice, in particular on wage dynamics, export orientation, human capital, labor productivity and competitiveness. Despite ongoing structural reforms, high unemployment continues to be a long-standing issue requiring urgent actions. The limited coverage of employment statistical data and the publication stop of the labor force survey are concerning. In this context, we would have appreciated a greater attention by staff to gender gap and youth unemployment. Could staff provide additional information on the impact of the envisaged reforms on these issues?

The financial sector is sound, and the peg remains appropriate, nonetheless potential criticalities should be monitored. The increase of credit growth complemented with higher LTV ratio (specifically the increase in mortgages given the decreasing real estate prices) could pose relevant risks going forward. As oil and oil-related exports remain dominant, the peg regime is recommended but should be carefully reviewed to support the non-oil tradable sector. In this regard, we wonder whether a more flexible exchange rate will be more suitable in the near future given the overall objectives of the Vision 2030 strategy. Staff comments are welcome.

Mr. Geadah and Ms. Abdelati submitted the following statement:

We thank staff for an insightful report and Mr. Mouminah and Mr. Alkhareif for their informative buff statement. We commend the authorities for pursuing structural policies that have led to continued growth of non-oil activity, which is expected to further strengthen in the coming years as the reforms take hold. A recovery in oil prices and production has supported a welcome strengthening of the current account and reserve accumulation, a pickup in credit growth, and a narrowing of the headline fiscal deficit. We agree that the exchange rate peg continues to serve the Saudi economy well. The focus of staff's discussions on further fiscal consolidation, economic diversification, and inclusiveness is appropriate.

Staff is concerned that fiscal consolidation has slowed. We recognize the importance of calibrating the pace of fiscal consolidation to ensure public acceptance of the adjustment policies, but it is also important not to reverse consolidation gains achieved. In this regard, we welcome the planned review and reform of social assistance programs to facilitate further consolidation. While we welcome the narrowing of the headline fiscal deficit in 2019, we see that higher spending in 2018 and in 2019 has increased fiscal vulnerabilities. We appreciate staff's concern over the procyclicality of spending, and gradual erosion of fiscal buffers, even though the Kingdom still retains substantial buffers. We note the difference with staff in terms of the fiscal and growth projections. Staff now believes that the authorities' target of a balanced overall budget in 2023 is out of reach, but this is based on more conservative assumptions with regard to the ability to restrain the wage bill and capital spending, and there is significant uncertainty over global oil markets and the growth impact of reforms. The non-oil primary balance remains quite large at 41 percent of non-oil GDP, and staff projects it to decline only to 36.5 percent of GDP by 2024. What is the authorities' projected date for reaching non-oil fiscal balance? We join staff in commending the important steps taken by the Macro-Fiscal Unit to improve fiscal transparency and fiscal policy analysis—including the planned publication of a mid-year budget starting this year—which will also facilitate communicating with the public in a timely manner.

Fiscal reforms—including VAT introduction raising excises and the foreign labor fees—and some one-off factors, supported a significant improvement in non-oil revenue thereby further reducing the dependency on oil in the fiscal accounts. Compared with 2016, when non-oil revenue amounted to 6 percent of GDP, it reached 13.5 percent of GDP in 2018 and it is projected to reach 17.2 percent of GDP in 2019-2020. However, it is expected to decline to 14 percent of GDP, so it makes sense to consider raising the VAT rate in consultation with other GCC countries or broadening the coverage of excises.

We agree on the importance of improving incentives for nationals to work in the private sector, and appreciate staff's analysis of labor market developments and the wage-productivity gap. The unemployment rate of Saudi youth is very high at around 40 percent, and the majority of unemployed are females with higher education, which is a tremendous underutilization of resources. We would welcome an explanation of why we don't see a pickup in TFP growth with the pickup in non-oil growth, while investment and employment declined. Staff's analysis shows that non-oil sectors' TFP growth turned negative since 2011 and through 2018. Non-oil investment significantly declined, and expatriate labor declined by about 1.75 million in the past two years.

Banking indicators are strong. Credit growth has picked up, especially for mortgage lending. However, as noted by the authorities, the LTV ratio was raised to 90 percent in 2018, and mortgage lending remains a small share of bank credit and the average LTV is well below SAMA's limit, and risks are reduced by the salary assignment of loans. SAMA's continued close monitoring of mortgage lending to ensure responsible lending practices is welcome. We also welcome efforts to improve financial access under the Financial Sector Development Plan.

We commend the authorities for sustaining the reform momentum and continuing to introduce new reform initiatives. Saudi Arabia ranks above the EM-average for many Inclusive Growth Indicators shown in Table 7. Rankings are particularly strong for government expenditure on health and on education, the business environment, and overall governance. However, further efforts in the areas of labor market, loans to SMEs, gender equity and inclusion, would close the gap with the average for emerging markets in these categories and further improve growth prospects. We applaud the importance placed by the authorities on increasing female and youth employment.

We wish the authorities continued success.

Mr. Sigurgeirsson and Mr. Vaikla submitted the following statement:

We thank staff for the comprehensive set of papers and y Mr. Mouminah and Mr. Alkhareif for the informative buff statement. We commend the authorities for their fiscal consolidation efforts, and the implementation of comprehensive socioeconomic reforms. Notwithstanding these positive developments, the Saudi Arabian economy is still vulnerable to economic shocks related to volatility in the global oil markets. In that regard, we encourage the authorities to continue with efforts towards fiscal consolidation, enhancing private sector growth, and reforms in the labor market. We broadly share staff’s appraisal and would like to offer the following comments for emphasis.

Implementing prudent fiscal policies is needed to reduce vulnerabilities to external risks. We commend the authorities for their efforts in improving the fiscal position, most notably by introducing the VAT, streamlining government spending, and adjusting subsidies and we welcome the authorities´ firm commitment to balancing the budget in 2023. However, given the uncertainty regarding oil price volatility, we agree with staff´s view that a tighter fiscal policy is needed to create additional fiscal buffers to mitigate potential shocks. We encourage the authorities to implement the announced fiscal policies and to consider further measures such as raising the VAT rate, containing the government wage bill, and reviewing capital spending plans while safeguarding social cohesion. We note that fiscal transparency has improved, while further enhancing fiscal disclosure as well as a strengthened legal framework for public financial management would further increase transparency and effectiveness.

Labor market reforms are essential to increase competitiveness and support inclusive growth. While economic activity has gradually picked-up in the private sector, we share staff´s concern that the public sector´s large economic footprint and high wages create serious challenges for private sector companies. To incentivize employees to work in the private sector, we encourage further reforms to the labor market by bringing the public sector wages in line with productivity, increasing work incentives in the private sector, strengthening training and education, and improving the effectiveness of labor market support programs. Furthermore, the high female unemployment rate points towards the need to promote female entrepreneurship, lower childcare costs, and to ensure that existing regulations carry no impediments to female employment.

We welcome the authorities’ comprehensive structural reform agenda to support economic diversification and job creation. We welcome the important progress that has been already made under the Vision 2030 in improving the business environment and facilitating businesses access to finance and encourage the authorities to continue this path. Given the extent of the envisaged reforms, it is crucial to ensure appropriate sequencing and prioritization. We share staff´s view that government support should be targeted towards priority sectors rather than specific companies, while being dependent on performance criteria and subject to close monitoring. We take positive note that significant investments are being made in infrastructure to develop Saudi Arabia as a global logistics center. Given these large capital investments, the authorities need to assure that the new public procurement law will be effectively implemented to strengthen spending efficiency and reduce risks of corruption.

Mr. Inderbinen and Mr. Makhammadiev submitted the following statement:

We welcome the sound policies and reforms pursued by the authorities under Vision 2030. The rebound in growth, including the pickup in non-oil growth, and the rising female labor force participation are encouraging. We welcome the progress under the Vision Realization Programs, and take good note of the authorities’ intention to retain a close engagement with the Fund in further implementing the important reform agenda. We note that dependence on oil revenues, a subdued role of the private sector, and the high unemployment rate of nationals remain important challenges. We thank staff for the good set of papers, and Messrs. Mouminah and Alkhareif for their helpful buff statement.

Fiscal consolidation should continue. We take positive note of the significant reduction in the fiscal deficit. Although the authorities have substantial flexibility in adjusting spending in case of lower oil prices, as emphasized in the buff, we concur with staff that procyclicality of spending should be reduced by relying on more conservative oil price assumptions. Fiscal consolidation would enhance the resilience to shocks, strengthen the external position, and allow to increase savings for future generations. We encourage the authorities to take into consideration staff’s recommendation to focus on the non-exported oil primary deficit (NEOPD). Containing the government wage bill, further energy price reforms and more targeted social assistance programs would generate additional fiscal savings.

The steps toward greater fiscal transparency are welcome. The structural fiscal reforms, including the digitization of the budget process, the lowering of the VAT registration threshold, and the adjustment of energy prices, are encouraging. We also acknowledge publication of the pre-budget statement and the intent to publish mid-year budget updates, and we encourage further advancement in fiscal transparency along the lines that staff lays out in Box 3. On a more general note, we very much welcome the announcement in the buff on the authorities' intention to subscribe to the SDDS by end-2019.

The authorities should exercise prudence in implementing non-oil revenue reforms. The successful introduction of the VAT is commendable. While we agree that there is some room for future increases in the VAT rate, it is important to consider that higher rates also tend to encourage tax avoidance and that rate increases can be costly to implement. This argues against all to frequent changes. It is important that the tax base for the VAT remains as broad as possible to maximize efficiency. Also, the gains generated by fees and taxes on tourism and entertainment should be weighed against their impact on the development of these sectors. The planned increase in the levy on expatriate workers should best be reconsidered.

We agree with staff that the monetary framework remains adequate. The peg to the U.S. dollar is adequate, given the structure of the economy. Going forward, and if a progressing diversification of the economy allows, alternatives to the peg may be worth exploring.

We welcome the strength of the Saudi financial sector. While the authorities should continue to closely monitor developments, the low level of NPLs and declining real estate prices should help stabilize the real estate market and maintain financial sector stability. Measures to increase access to financial services under the Financial Sector Development Program are encouraging, but the outcome will also depend on the promotion of a competitive environment.

Incentivizing employment in the private sector and improving cost competitiveness will be crucial for diversification. Given that employment preferences are currently skewed toward the government sector, labor market policies should enable incentives for private sector jobs. At the same time, as noted in the SIP, the private sector may be uncompetitive internationally. Developing human capital by strengthening education and training will be key to gradually increasing the productivity of nationals and narrowing the productivity-wage gap. The authorities may also consider additional measures proposed by staff, including wage subsidies for nationals in the private sector. Government support should crowd in the private sector without promoting individual companies.

Ms. Mannathoko and Mr. Odonye submitted the following statement:

We thank staff for the report and Mr. Mouminah and Mr. Alkhareif for their informative buff statement. Saudi Arabia has made good progress in implementing reforms, with positive outcomes seen for non-oil growth, employment and female labor force participation. With GDP growth at over 2 percent in 2018, we commend the authorities on the successful reversal of the declining growth trend seen since the 2014 oil price shock and OPEC oil-production cuts that led to the 2017 recession, and higher unemployment. We have the following comments on fiscal policy; monetary, financial and external sector policies; and growth and employment.

Fiscal Policy

We welcome the positive growth seen in 2018 in response to the strong counter-cyclical fiscal stance adopted by authorities. Higher government spending served to offset the adverse impact of the oil price shock. We also appreciate the efforts made by authorities to support stability in global oil markets; despite their contractionary impact. With oil accounting for a third of GDP and oil production cuts taking place in the first half of 2019, we understand the authorities' concern over staff's recommendation to tighten spending, as a premature shift to a tight fiscal stance could lead back towards recession. It may make sense to defer larger spending cuts until the recovery is more entrenched. In this regard we note that this could be a year or two from now, as oil production cuts may be reversed in 2020 depending on market developments in the medium term, and positive spillovers from large infrastructure projects in the pipeline will serve to boost non-oil growth in the future. The authorities also have a contingency plan that would adjust the spending profile in the event of an oil price decline (paragraphs 21-22). What are staff views on the details of the contingency plan? Is there scope to reach consensus with authorities on contingency measures in lieu of investment spending cuts? Taking note of the 2023 balanced budget goal, our inclination is to support growth friendly fiscal consolidation, which would mean continuing with planned investment spending wherever it can be done efficiently; and seeking ways to reduce recurrent expenditure and improve domestic resource mobilization. In this regard, staff views on the timing and expected magnitudes of downward wage-bill adjustments under the authorities' wage-bill reduction plan, are welcome.

Monetary, Financial and External Sector Policies

We take positive note of the improvement in credit and liquidity conditions. However, the rapid expansion in mortgage lending requires surveillance, and we (like staff) encourage monitoring of this expansion in household lending which could have adverse outcomes in the event of a downturn and job losses. We also note that the capital markets authority plans to launch a derivatives market by end-2019, as part of reforms to deepen domestic financial markets. Could staff elaborate on these plans? Improving financial access is also important, and we note that the development of agency banking and fintech can play a prominent role in this regard for the underserved including SMEs, women and youth. As financial inclusion measures are pursued, we encourage authorities to continue to safeguard system-wide stability taking into consideration the implications of digital platforms.

On exchange rate policy, we note that post GFC, the REER shows an appreciating trend; however, one would normally expect the opposite policy response given the deterioration of the external balance after 2011. It seems the authorities chose to draw on reserves rather than allow some adjustment via the exchange rate. Given the need to grow non-oil production, could staff elaborate on how they are advising authorities with regards the sustained real exchange rate appreciation shown (page 35), with over 20 percent real appreciation since the GFC despite the sustained decline in real GDP growth from 10 percent in 2011 to the recession in 2017?

Growth and Labor Markets

We commend authorities on progress made in improving the investment climate, including the implementation of bankruptcy and commercial pledge laws. We encourage further measures needed to improve the business climate, implementation of privatization and PPP programs, and continued progress on governance and AML/CFT reforms. With the promotion of non-oil growth and the creation of jobs for Saudi nationals cited as priorities, the business environment and the crafting of the role that the government plays in crowding in private investment will be key. Equally important, will be a full understanding of the factors that have led to the sharp collapse in TFP growth from 2011 onwards (page 55). There appears to be a structural break impacting TFP in 2011. Do staff have a sense of what exactly caused the break? Is it related to labor markets or technology use, for example? We note that staff reporting attributes the break to the 2008–09 global crisis, but it remains unclear what aspects of the GFC triggered a sustained contraction in TFP from 2011 onwards? Do staff have specific recommendations for the authorities on how to overcome this contraction?

With respect to labor market reforms, we commend the authorities on progress made in employing nationals – and in particular, women. However, even though taxes levied on expatriate labor will help to shift incentives towards local labor while adding to revenues, it is unclear what the net economic outcome will be. Could staff comment on the findings of IMF or World Bank empirical analysis of the outcome of these labor market reform measures? What are the effects on the business climate? What are the medium to long term (economic transition) implications of the departure of hundreds of thousands of foreign workers? What is the net economic benefit or cost and the implication for TFP? Can staff share their views on alternative reform models considered in the quest to normalize the structure of the Saudi labor market?

With these comments we wish the Saudi authorities success in their reform efforts.

Ms. Riach and Mr. Masood submitted the following statement:

We thank staff for a very clear and comprehensive report, as well as Mr. Mouminah and Mr. Alkhareif for their insightful buff statement. We agree with the thrust of the staff report. We commend the authorities on the progress made on economic and social reforms under Vision 2030, and on recommendations for the 2018 Article IV and 2017 Financial System Stability Assessment reports. These measures have begun to support acceleration of growth, female participation rates and non-oil budget revenues, and the reduction of gasoline and electricity consumption following the energy price reforms. Reforms should be inclusive and protect vulnerable households from negative effects. Social spending should help to ensure a progressive distributional impact.

We agree with staff's assessment that fiscal headroom has reduced since the 2018 Article IV and there are risks from prioritising near-term growth, particularly if oil prices are lower than forecasted. Higher, procyclical government spending could risk pushing fiscal consolidation off-track. Ensuring that the spending level can be maintained across different oil-price environments will reduce volatility and benefit long-run growth. Furthermore, if delays in implementation e.g. energy subsidies, or reversals of reforms e.g. public sector remuneration, are repeated in future, there is a risk of decreasing credibility of the reform with international lenders.

Continued implementation of measures to diversify the economy will also be important to help to insure against oil price volatility. We note the negative productivity growth in the non-oil sector over the last decade. While an increased growth rate in the non-oil sector – driven by government spending and increased confidence and liquidity – is welcome, productivity growth in the non-oil sector will be essential for the economy to diversify away from oil. Further data might make it easier to identify key problems to help address this.

We commend the authorities' success in increasing in female participation in the labour force to 20.5 percent, but this still has a long way to go with female unemployment at 31.7 percent. We encourage further reforms in the labour market, and more widely, that increase female economic participation. Increasing female labour force participation and employment is essential to maximise output, productivity growth and individuals' incomes.

Finally, we welcome the new public procurement law and reforms to the procurement process. This should help to reduce the risk of corruption and promote value for money in government spending.

Mr. Guerra submitted the following statement:

We thank staff for the set of comprehensive reports and Mr. Mouminah and Mr. Alkhareif for the insightful buff statement. We broadly agree with the staff appraisal and fully support the authorities' resolve to implement their ambitious reform agenda.

As stated in the buff, the authorities are fully committed to implementing several structural reforms to further diversify the economy, promote private sector-led growth, create job opportunities for youth and women, and strengthen fiscal sustainability and transparency. In this regard, we support the staff's assessment that labor markets with the right incentives will be instrumental to achieve economic diversification and higher participation of the private sector in economic activity. We also highlight the continued efforts of the authorities to increase female labor participation, which continues to rise.

We also support the authorities' commitment to meet the medium-term fiscal targets irrespective of the future path of oil prices. The authorities should have the flexibility, while being mindful of the impact on growth, to implement the necessary fiscal policies in order to secure fiscal targets in the medium term, either through increased revenues or by postponing non-priority spending to later years. In this regard, we highlight that the fiscal position continues to improve, including with the successful introduction of the VAT in 2018. Going forward, it will also be important, as fully recognized by the authorities, to continue the significant progress in developing the debt managing framework. Finally, on the fiscal front, continued efforts will be necessary to strengthen fiscal transparency as presented in the staff appraisal. In a related matter, recent improvements in economic data are welcomed. In this regard, we commend the authorities' determination to subscribe to the SDDS before the end of this year.

In a context of a profitable, liquid and well capitalized banking sector, it is important to deepen access to financial services, in particular for the young, women, and SMEs. In this regard, we notice that the implementation of the Financial Sector Development Program is advancing its aim to reach a more diversified financial sector and support investment. Finally, we would ask staff to comment on the recent increase in mortgage lending amidst the decline in real estate prices. In particular regarding the measures that have been either implemented already or are being planned to confront the eventuality of any increase in non-performing loans.

With this, we wish the authorities success in their endeavors.

Mr. Rosen, Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the comprehensive Article IV report and the interesting Selected Issues Papers. We are encouraged that the Saudi authorities are beginning to implement the Vision Realization Programs (VRPs) under Vision 2030. Amid a pick-up in economic growth in 2018, this is an auspicious timeframe to move forward with their ambitious economic transformation program. We broadly agree with the staff appraisal in the Article IV report.

We echo staff's call that greater economic diversification is needed to create jobs and increase economic resilience amid a growing labor force and uncertain energy markets. The Selected Issues paper was particularly useful in this regard, and boosting the private sector's role in the economy will require a bold set of structural reforms. We encourage the authorities to improve the business environment, reduce the gap between the public and private sector on wages and productivity, and strengthen governance. Amid a still large public sector economic footprint, we also agree with staff that government spending and other interventions should crowd-in and not crowd-out the private sector.

Regarding fiscal policy, we note that the fiscal deficit has narrowed in recent years but continue to believe that gradual fiscal consolidation is necessary to rebuild fiscal space. Further strengthening fiscal transparency is critical as well, and we echo the messages from Box 3 in the report. Providing more detailed data on budget projections, outturns, and fiscal risks can support a more efficient allocation of government resources, improve accountability, and reduce the risks of corruption. On a related note, we welcome the new public procurement law and encourage the authorities to have all government procurement covered by the reforms. Robust implementation of the new law will also help reduce corruption risks and enhance government spending efficiency.

We agree with staff that the exchange rate peg remains appropriate and provides a strong and credible policy anchor. We still encourage the authorities to review the peg regularly and continue reforms that would allow for a more flexible exchange rate regime in the future, should it become appropriate.

Finally, we encourage the authorities to consent to publication of the Article IV report.

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the informative set of papers and Mr. Mouminah and Mr. Alkhareif for the useful buff statement. We are pleased to note that the comprehensive reform program in Saudi Arabia is bearing fruit. Going forward, we encourage the authorities to maintain this positive momentum, and sustain their reform efforts to promote sustainable and inclusive growth. We broadly agree with the thrust of staff's appraisal and would like to make the following comments for emphasis.

On fiscal policy, progress has been made in strengthening the fiscal framework, and additional fiscal measures are needed to strengthen fiscal buffers and reduce medium-term vulnerabilities. We welcome the authorities' reform efforts in strengthening the budget process and developing a medium-term fiscal framework. Going forward, a reduction in the government wage bill and a more measured increase in capital spending should yield fiscal savings, and improvement in expenditure management should continue while enhancing fiscal transparency. In the process of fiscal adjustment, it is crucial to ensure that the vulnerable remains adequately protected. In this regard, we welcome the authorities' ongoing review of social assistance program.

On oil prices, we take note of the different views between staff and authorities on the oil price assumption and understand that the main risk facing the country is the uncertainty in global oil markets. We would welcome staff's comments on the extent the oil prices risk could be mitigated by the production decision of Saudi Arabia itself. What is the oil production cost of Saudi Arabia compared with its peers?

On structural reforms, we welcome the authorities' ambitious reform agenda to revive the non-oil sector. We agree that policies should support priority sectors rather than specific companies and performance criteria should be strict. To improve competitiveness of the private sector, it is essential to keep the wages of Saudi workers consistent with productivity and narrow the productivity-wage gap.

On the financial sector, broader access to financial services and more market competition will lend further support to the economy. We take positive note that capital market reforms have facilitated Saudi Arabia's inclusion in global equity and bond market indices this year. The intended launch of a derivatives market by year-end would help further deepen the domestic financial market. We support the authorities' efforts to explore agency banking and Fintech for a more developed, accessible, and competitive financial sector.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Di Tata and Ms. Moreno submitted the following statement:

We thank staff for the interesting set of papers and Mr. Mouminah and Mr. Alkhareif for their insightful buff statement.

Saudi Arabia's ongoing reforms in the context of the authorities' agenda under Vision 2030 are beginning to have a significant positive impact on the economy. Following a decline in 2017, real GDP grew by 2.2 percent in 2018, with non-oil GDP growth supported by higher government spending, increased confidence, and improved credit conditions. The current account surplus widened in 2018 reflecting mainly higher oil exports and lower outflows of remittances, SAMA's NFA position remains strong at 26.7 months of imports, consumer and real estate prices fell in the first quarter of 2019, and stock and bond markets have had a strong performance. At the same time, the unemployment rate of nationals has declined, although it remains elevated. The overall economic outlook is positive, with non-oil growth projected by staff to strengthen to about 3 -3 ¼ percent over the medium term as reforms take hold. Risks are broadly balanced, with the main downside risk being lower oil prices and production. Diversification away from oil is an important part of the government's reform agenda. We would appreciate if staff elaborates on the main differences between their growth projections and those of the authorities, who envisage higher growth.

The authorities plan to proceed with fiscal consolidation over the medium term. The fiscal deficit narrowed markedly to 5.9 percent of GDP in 2018. Both oil and non-oil revenues rose strongly, with the latter increasing to 15.3 percent of non-oil GDP, from 10.2 percent in 2017, owing in part to the introduction of the VAT, a landmark achievement. On the expenditure side, current spending increased relative to GDP, while capital outlays were reduced through improved allocation of funds to viable projects. Going forward, we welcome the authorities' firm commitment to meet the fiscal target of balancing the budget in 2023. At the same time, we acknowledge the differences of opinion between staff and the authorities regarding the medium-term projections for oil prices and spending. In this regard, we take note that staff has assumed a higher path for government spending than at the time of the 2018 Article IV consultation. Could staff elaborate further on these differences of opinion, including with respect to the projections for oil prices, which the authorities regard as pessimistic? We agree with staff that the implementation of announced fiscal measures already incorporated in the fiscal projections constitutes a priority. At the same time, we understand that the authorities have additional policy levers that can be used if needed to achieve the fiscal targets, which differ from the additional fiscal measures recommended by staff.

We welcome recent reforms to strengthen the fiscal framework and concur with staff on the need to reduce the procyclicality of government spending and further increase fiscal transparency. We commend the authorities for the implementation of reforms to upgrade fiscal policies and public financial management, including through the digitalization of the budget process; the recent approval of a new procurement law that will enhance spending efficiency, governance and accountability; and the efforts under way to improve fiscal transparency. At the same time, we encourage the authorities to place greater emphasis on the non-exported oil primary deficit (NEOPD) to better delink spending from oil price volatility; improve fiscal risk analysis and disclosure, including by presenting information on contingent liabilities; expand the publication of fiscal data to important budgetary funds and public corporations; and increase the transparency of PIF's operations. We take positive note of the progress made by the Debt Management Office in developing a debt management framework and coordinating borrowing decisions with other government entities.

The banking sector remains adequately capitalized, profitable, and liquid. We welcome the issuance of new bank licensing regulations in December 2018 as well as the entry of five foreign banks, which is expected to increase competition. Although risks at this stage are limited, we encourage the authorities to continue to monitor closely the quality of real estate lending and take mitigating measures if necessary. We acknowledge the important progress that has been made towards developing a more open and dynamic capital market, which has culminated with Saudi Arabia's inclusion in global equity and bond market indices and increased participation of foreign investors.

We welcome the authorities' ongoing efforts to diversify the economy and further enhance the role of the private sector in growth and job creation. Going forward, we encourage them to press ahead with their plans to improve the business environment and develop new economic sectors by fostering foreign direct investment, boost the productivity of Saudi workers by strengthening education and training, implement labor market reforms focused on improving the competitiveness of nationals for employment in the private sector, increase female labor force participation, and further enhance the governance and anti-corruption framework. We concur with staff that fostering a vibrant and competitive SME sector requires developing an appropriate institutional framework to support SME and entrepreneurship financing while avoiding market distortions and contingent fiscal risks. We take note of the low share of bank lending to SMEs, which is estimated at about 5 percent.

We encourage the authorities to continue with their efforts to address data gaps and to subscribe to the Fund's Special Data Dissemination Standard.

With these comments we wish the Saudi Arabian authorities every success in their future endeavors.

Mr. Mojarrad and Mr. Sassanpour submitted the following statement:

We thank staff for a well-written report and Selected Issues Paper. As reflected in the report and highlighted in the insightful buff statement of Mr. Mouminah and Mr. Alkhareif, guided by Vision 2030, good progress is being made in addressing Saudi Arabia's long-standing socio-economic challenges—key among them, reducing the economy's reliance on oil income and boosting private sector activity and employment of Saudi nationals—while protecting those that are not well-off during the transition. We broadly agree with the staff appraisal.

On the fiscal front, the recent gains in non-oil revenue, including from the VAT and excises, are noteworthy. Proceeds from settlement agreements also contributed significantly to revenue in 2017-2018 and are projected to continue in 2019. Are these one-offs revenues or are they expected to continue as a major source of revenue in coming years? Like staff, we are of the view that the discussion of fiscal policy would benefit from the adoption—for analytical purposes—of a fiscal measure that delinks fiscal policy from oil price developments. Staff's Non-exported oil primary deficit (NEOPD) concept serves that purpose and deserves consideration. In the same vein, consolidating the central government accounts with the fiscal operations of autonomous government institutions, and particularly the Public Investment Fund (PIF), in view of its growing fiscal role, will make the underlying fiscal position more transparent and policy prescriptions more effective. In staff view, are there any issues other than the PIF's current transition from cash to accrual accounting that may delay a consolidated fiscal reporting?

We note the divergence of views between staff and the authorities on the fiscal outlook based on current policies, which mainly reflects differences related to the oil price assumptions and the adequacy of fiscal buffers and fiscal space. While we recognize that Saudi Arabia's substantial financial assets (within and outside the central government) are a major source of comfort, we note staff's position that fiscal buffers are now significantly weaker than in 2014 when oil prices collapsed—and are even lower than last year's because of the higher expenditure path—and hence the economy remains vulnerable to the next oil price shock. Fiscal prudence calls for expenditure policies that are sustainable across different oil price scenarios. We support staff suggestion to tighten the fiscal stance over the medium term. We also support slowing the planned increases in expatriate levy to reduce the drag on non-oil economy. We welcome the progress in strengthening the fiscal framework and transparency and budget execution, including through the adoption of a new procurement law and its implementation through the "Etimad" portal.

We agree with staff that, given the structure of the economy, the exchange rate peg has been appropriate so far and should continue, subject to regular reviews. We note that financial sector reforms have broadened and deepened the capital markets. The banking system is strong and there are no issues of immediate concern, even though the rapidly expanding mortgage lending requires vigilance. The staff report also flags the weak incentive for domestic banks to compete because of their significant common ownership, especially by the PIF and pension funds. A thorough review of the banking system and its ownership structure with a view to improving competition among domestic banks and delivering on the Financial Sector Development Program (FSDP) objectives seems timely and prudent. We note that sharia-compliant financial products are expanding. Could staff comment on the adequacy of supervision of Islamic banking activities?

Diversification of the Saudi economy is grounded in Vision 2030, and a number of Vision Realization Programs (VRPs) are geared towards that objective. We note that most VRPs are expected to be completed by 2022. In staff view, would that be sufficient to ensure the achievement of Vision 2030 goals? The key challenges in diversification are to increase the scope of private sector activity and employment and its large footprint in the economy, and to support the transition by strengthening the regulatory framework and institutions. Real non-oil GDP growth has been anemic since the GFC, reflecting—according to staff analysis—slower employment growth and capital accumulation, and negative TFP growth. Moreover, labor productivity growth has been low and falling and lags wages, while there is significant room to improve the efficiency of capital spending. We agree with staff that focused product and labor market reforms and investing in human capital and innovation are key to boosting productivity.

The recent government efforts to increase the participation of women in the labor force and encourage nationals to seek employment outside the government are steps in the right direction and have already borne positive results. Changes in civil service employment and wage and benefits policies could help lower the reservation wage of nationals while targeted support policies at sector level could facilitate their employment in the private sector. The expatriate levy has raised the cost of foreign labor. Who bears the cost, the firm or the employee, or is it shared? And to what extent has the levy effectively narrowed the public-private wage gap?

Finally, we welcome the authorities’ intention to subscribe to the SDDS before the end of this year, as indicated by Mr. Mouminah and Mr. Alkhareif.

Mr. Raghani and Mr. Lopes Varela submitted the following statement:

We thank staff for the set of insightful papers and Mr. Mouminah and Mr. Alkhareif for their informative buff statement.

We commend the Saudi Arabian authorities for the significant progress in implementing their socioeconomic reform agenda “Vision 2030”. Higher oil prices and efforts to boost non-oil GDP contributed to the economic recovery, a stronger current account surplus and a better fiscal position in 2018. The outlook remains broadly balanced with non-oil growth expected to increase in 2019 and over the medium-term. However, downside risks remain, mainly from the volatility in the global oil market and global trade tensions, which may pose challenges to the country’s prospects. Moving forward, the continued implementation of the reform agenda is warranted to increase the country’s resilience to volatile oil prices, expand the non-oil sector, and create more private sector jobs.

We broadly agree with the staff’s assessment and policy advice and would like to highlight the following points for emphasis.

Although significant achievements have been made, continued fiscal consolidation is needed in the face of oil price volatility. The policy measures and reforms that are being undertaken, paired with strong revenue performance in both the oil and non-oil sectors, led to a sharp reduction in the fiscal deficit to 5.9 percent in 2018 from 9.2 percent in 2017. The authorities’ ongoing efforts to balance the budget by 2023 is welcome. Nevertheless, achieving this objective could prove challenging in case oil prices over the medium fell below the authorities’ oil price assumption. We would appreciate staff elaborating on the differences in oil price assumptions between the Fund and the authorities. Further efforts toward containing expenditures are also needed to achieve the targeted reduction in the non-exported oil primary deficit (NEOPD). In this vein, we encourage the authorities to explore as many options as possible, including energy and water price reforms. We also see merit in controlling the wage bill as well as enhancing public investment efficiency, which will contribute to maintaining strong fiscal buffers.

We encourage the authorities to pursue their efforts in reinforcing public financial management. The authorities have put in place an enhanced budget process, a medium-term fiscal framework, and an on-line expenditure management system which have helped strengthen public finances. Also noteworthy are the measures to ensure greater fiscal efficiency and transparency, including the recent passage of the procurement law. We encourage the authorities to take the necessary steps to streamline tax exemptions for institutions that are financed by the budget and to publish more comprehensive budgetary execution reports.

The authorities' monetary and exchange rate policies are broadly appropriate, but continued vigilance is required. We invite the authorities to monitor price and activity developments closely and to stand ready to adjust the monetary policy stance as needed. On the exchange rate, we concur that the peg remains a credible anchor at this juncture as it helps in limiting uncertainty and in keeping inflation pressures under control.

We welcome the remarkable progress made in the development of the financial sector, which remains profitable, liquid, and well-capitalized. In line with the 2017 FSSA, actions have been taken to improve banking oversight, enhance liquidity management, reinforce financial safety nets, and strengthen macroprudential policies. We take good note of the issuance of the new banking licensing guidelines, the preparation of instructions to reschedule and restructure loan payments, the ongoing development of a liquidity management framework, and the opening of the Saudi Arabia's debt market to allow the entry of foreign investors. However, recent developments in housing financing and the real estate market warrant close monitoring to prevent the build-up of risks to the financial sector. In addition, we encourage the authorities to swiftly undertake reforms aimed at deepening domestic financial markets and expanding access to financial services while strengthening the AML/CFT framework.

Structural reforms to diversify the economy, promote employment, and foster more active private sector participation are essential to achieving sustainable and inclusive growth. Commendable efforts are being made in diversifying the economy and creating jobs through Vision 2030. In this regard, the authorities should put emphasis on further enhancing the cost competitiveness of the economy and creating a more conducive business environment. To this end, effective labor market policies and increased female labor force participation will be paramount to buttress inclusive growth. We welcome the staff's analysis in the Selected Issues paper on the policies to promote economic diversification in Saudi Arabia. The main takeaway is the importance of properly targeting, structuring, and sequencing measures to bolster specific sectors.

With these remarks, we wish the authorities of Saudi Arabia success in their reform agenda.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for the informative set of papers and Mr. Mouminah and Mr. Alkhareif for their helpful buff statement. Since 2016 Saudi Arabia has been implementing the ambitious reform agenda under the Vision 2030 aimed at promoting non-oil growth and economic diversification, increasing the role of the private sector, and raising employment of Saudi nationals. These reforms are starting to yield first results. Growth has picked up in 2018, and unemployment has declined. The fiscal deficit has been narrowing rapidly over the past two years, while non-oil revenue has been increasing. We welcome progress in strengthening fiscal framework, developing capital markets, improving legal framework and enhancing business environment.

Notwithstanding recent positive dynamics, substantial near- and medium-term risks to the outlook remain. We also note that fiscal buffers have declined sharply over the past five years. Prudent fiscal policy should remain the cornerstone of the authorities' strategy, given high level of uncertainty in global oil markets and geopolitical tensions in the region. Further progress in improving competitiveness and employment of nationals is necessary to develop a robust non-oil sector.

We welcome the authorities' commitment to achieve balanced budget by 2023. At the same time, we note substantial divergence between the authorities' and staff's medium-term fiscal forecasts, which was also the case at the time of the 2018 Article IV consultations. For 2023 staff forecast the overall fiscal deficit of about 6.4 percent of GDP, which is even higher than the last year forecast. The authorities expect higher oil prices, stronger revenues and more limited expenditure growth than staff. At the same time, the authorities are ready to identify and introduce further fiscal measures if needed. As some of the possible measures are already proposed by staff, it is important that the authorities and staff continue the dialog to bridge the gap between diverging assessments and to implement the necessary adjustment.

We take note of the recent progress in strengthening the fiscal framework, including introduction of the online expenditure management system and adoption of the new procurement law. At the same time, the authorities could do more to reduce the volatility of government spending, which fluctuates widely following oil price developments. In this regard, we note staff's advice to put greater emphasis on the Non-Exported Oil Primary

Deficit (NEODP), which can serve as an anchor for fiscal management. Further steps in enhancing fiscal transparency would be beneficial for the budget process, including improving transparency of the Public Investment Fund. We also welcome the authorities' achievements in the debt management area, such as better coordination among government entities and diversification of sources of financing.

Saudi Arabia's banking sector remains sound. Most banks are well-capitalized and profitable, and resilient to severe shocks. At the same time, the rapid growth of mortgage lending, although from a low base, requires careful monitoring by regulators. We commend the authorities for their efforts in developing the capital markets, and welcome Saudi Arabia's inclusion in the global market equity and bond market indices in 2019. Recent liberalization of foreign ownership for strategic investors will provide additional impetus to development of the Saudi capital markets.

Growth of non-oil economy requires reforms on multiple fronts. We note that government-supported development programs could be more efficient in nudging private companies to enter the new sectors. Competitiveness of domestic private sector should be enhanced. One of the key challenges in this respect is to reduce current gap between wages and productivity of local workers. Strengthening education and training of local work force is important but should be complemented by other measures aimed at increasing incentives to work in the private sector. Higher female labor force participation can substantially boost economic performance, and we encourage the authorities to reduce remaining barriers to female employment.

We welcome the authorities' intention to subscribe to the SDDS before the end of this year, which is important for strengthening the quality and availability of statistical data. We also encourage the authorities to consent to the publication of the Article IV report.

With these remarks, we wish the authorities further success.

The Acting Chair (Mr. Zhang) made the following statement:

Saudi Arabia is continuing to implement an ambitious economic reform agenda, as it seeks to strengthen and diversify its economy and also create jobs for the young population. Many of us have been through several discussions of the Article IV in the past number of years, and we all have witnessed the changes that have taken place each and every year.

As the staff noted, the reforms appear to now be having a positive impact on the economy overall. At the same time, there are uncertainties down the road, particularly concerning the volatility of the global oil market, in addition to the global outlook, geopolitical tensions, and so forth. It is important that the policies and policy frameworks are set up in a way to minimize the impact of the volatility on their domestic economy. This is the key message that the staff is trying to send.

The next one and a half-year period is very important for Saudi Arabia, as it will be assuming the G20 presidency next year. All of us are looking forward to the opportunity to support its presidency and work with the authorities on their priority areas.

Mr. Mouminah made the following statement:

I thank Directors for their support for the authorities' far-reaching economic and social reform agenda and for the recognition of the comprehensive reform that has already yielded encouraging results.

I personally believe that the impact and the realized gains for the ongoing reforms must be looked at in an appropriate context of the reform momentum over the past four years. I hope that Mr. Callen will shed some further light—being the mission chief of the country and a frequent visitor to Saudi Arabia—on how things have actually changed over the past period.

The authorities are implementing an ambitious reform program across a wide range of sectors. I want to take this opportunity to highlight the sweeping developments in the new priority sectors of tourism and entertainment. I will also cover fiscal policy and developments related to female empowerment in my opening remarks.

On tourism and entertainment, in 2018, the General Entertainment Authority's calendar featured more than 5,000 events hosted across more than 50 cities in Saudi, including family shows, stand-up comedy, and live performances from some of the biggest names in global music. This includes Cirque Du Soleil, World Wrestling Entertainment (WWE), and FIA Formula E racing. Why am I saying this? To everyone else, it seems like a normal day. To Saudi Arabia, this is transformative. This has created a new sector in the country and investment opportunities, leading to the establishment of more than 500 companies in 2018 alone and in the entertainment sector specifically. Vision 2030 aims to double the consumer spending on activities and attractions within the kingdom.

On a related note, I would like to mention that Saudi Arabia has already attracted many visitors for religious purposes. However, our authorities are expanding the tourism sector and hope that these efforts will help attract new tourists to Saudi Arabia. To make this happen, a new visa system, e-visa, will be made available this year to a wide range of nationalities. I would like to welcome all of you to experience these positive changes taking place by visiting Saudi Arabia. I am sure many of our colleagues around the table will visit Saudi Arabia next year during our Saudi G20 presidency, which we will be happy to take over from the presidency of our Japanese partners.

On female empowerment, as highlighted in the staff's written answers, the recent period has been momentous for Saudi Arabia. The enablement of women has played a big part and role in the economy. This is not to say that we have done enough when it comes to women. Rather, it is a priority, and we will do more. I want to shed light on some examples. We removed impediments to women's participation in sectors such as sports, military, aviation, and others. We removed the restrictions on driving, which seems to be normal for everybody else, but for us, it facilitates greater female participation in the labor force.

Women are occupying prominent international, governmental, and business positions. An example is that Saudi Arabia's first female ambassador presented her credentials this week in Washington, D.C. I also mention the Deputy Minister for Women's Empowerment and the chairperson of the Saudi Stock Exchange. Across the halls of government, you will actually see and feel that.

On fiscal policy, let me reiterate that the authorities remain committed to balancing the budget in 2023, regardless of the future path of oil prices. To help achieve their fiscal targets, the authorities have identified contingency measures, outlined in staff's written answers, which could be used, if needed. The authorities see merit in implementing fiscal policy in a flexible manner within the medium-term fiscal plan, with a view to support growth, especially to enhance the role of the private sector while sustaining fiscal consolidation. In this context, overachieving our target for the fiscal deficit last year reflects sustained efforts toward the rationalization of subsidies, streamlining government spending, and promoting a diversified and sustainable revenue base. This underscores the authorities' continued commitment to fiscal reforms and their discipline in maintaining sound fiscal policy with strong buffers.

My authorities have consented to the publication of the staff report, as was the case in previous years. I will come back with additional remarks toward the end of this discussion.

The staff representative from the Middle East and Central Asia Department (Mr. Callen), in response to questions and comments from Executive Directors, made the following statement:[1]

Before I start, I would like to thank Mr. Mouminah, Mr. Alkhareif, and all the staff in the Saudi Arabian office for their support during the consultation. I am going to focus my remarks on two issues. The first issue is the fiscal projections and the fiscal policy advice, and then the second is on the labor market reforms.

As has been well documented in the buff statement and in the Directors' gray statements, there are differences between the staff's and the authorities' fiscal projections. These stem mainly from the path of revenues the government will receive from oil exports and differences in the path for current spending. We do not know the exact path of the authorities' oil price in the budget, but they have told us it is higher than ours. As is standard for Fund country teams, we are using an oil price which is consistent with the World Economic Outlook (WEO) baseline.

On current spending, staff is not yet convinced that the measures are in place to achieve the budget targets. The authorities have a very ambitious plan in terms of current spending, where they are assuming no nominal growth in that spending from the 2018 outturn through 2021.

It is certainly encouraging that the budget was in surplus in the first quarter of this year; but in past years, fiscal trends early in the year have not provided a good guide to the annual outcomes, particularly on the expenditure side. Large increases in spending in the fourth quarter of the year have happened and have often caught staff by surprise. Maybe as an example of that, we have underestimated the size of the fiscal deficit in the staff report in two out of the past three years, and that is largely because spending has exceeded what we had expected at the time of the Article IV consultation.

Ensuring that spending is kept at budgeted levels this year, following the overruns we have seen in the past three years, will definitely strengthen

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

the credibility of the authorities' expenditure projections and would provide grounds for us to revisit the medium-term expenditure path in our projections.

I also wanted to emphasize that we do have a considerable fiscal adjustment already built into our projections in the staff report. We project that spending, if we exclude interest payments, will decline as a share of GDP slightly, and it will decline quite substantially as a share of non-oil GDP. On the revenue side of the projections, we assume that additional energy price reforms will take place over the next five years and that the expatriate levy increases will continue as planned. This gives us 5 percent of GDP of additional revenues from these two sources in the projection period. All in all, the non-exported oil primary deficit is projected to climb by 13 percent of non-oil GDP between 2018 and 2024.

There is no disagreement between staff and the authorities about the fact that their fiscal consolidation needs continue. The difference boils down to the fact the authorities believe they already have enough policy measures in place to deliver on the adjustment, and staff is not yet convinced that it is the case. We are recommending additional measures, which should be gradually implemented, to reduce the risk that a sharp expenditure adjustment could be needed in the future if oil prices fall. Staff believe that such procyclical policy is harmful to investment, growth, and fiscal policy credibility and would rather see a smooth path of spending that is more resilient to swings in oil prices.

Turning to the labor market, and picking up on Mr. Mouminah's request, which is important in terms of taking a perspective on the changes, as many Directors know, I have held this job for a number of years now and have been a regular visitor to Saudi Arabia. It is striking to witness the changes that have taken place over that period. Each time I visit, I notice further changes. If you go there even two years ago, it was rare for us to see a Saudi—whether it was a male or a female—working in hotels, restaurants, and retail shops. Now it is quite common. It was also rare that two years ago for women to attend our meetings, whether in the public or the private sectors, and if they did attend, it was often not in an active participatory role. Now many women are attending the meetings and are actively participating. As one example, the new macro-fiscal unit set up in the Ministry of Finance now has between 20 and 25 staff, and about half, if not more than half, of those are females. There is much further to go on this, but there have definitely been positive changes.

One of the questions is why what we see on the ground is not really being reflected in the labor market statistics. One possible answer is that what we are seeing is unrepresentative of the whole country because we clearly only visit the big cities. But the sense is that that is not true, that it is much more general than that. It is also possible that the statistics are not capturing the situation on the ground adequately, and we have expressed concern to the authorities about the quality of their labor market statistics. The growth in Saudi employment may be stronger than in the official data. The private sector employment data are based on registrations with the private pension fund. Maybe that is not capturing some of the new aspects of job creation that are there. This is clearly an important area, along with other statistical issues, where strengthening the statistics will be important in terms of judging policy progress and how policies are achieving the targets that have been set out.

Finally, I do think things are changing and policies are beginning to work. More is needed because the employment challenge, given that the young population and the high unemployment rate of nationals at present are large. Reforms need to continue to make the private, rather than public sector employment the first choice for Saudis, to strengthen education, training, and active labor market policies, to remove impediments to the mobility of expatriate workers in the economy by abolishing the sponsorship system and continuing to enable and encourage women to enter the workforce. Ultimately, as we say in the staff report, if the Saudi economy is going to be internationally competitive, wages of nationals will need to reflect their productivity levels. Closing this gap will be one of the most important challenges, if the reforms are going to be successful.

Mr. Kaizuka made the following statement:

Since Japan and the Saudis are now very close and intimate colleagues in the framework of the Troika for the G20, I feel obliged to speak first. I thank Mr. Mouminah for the introductory explanation on the entertainment tourism, which definitely encourages and incentivizes my staff working on the G20, working in Tokyo, to pay frequent visits to Riyadh or some other places in Saudi. I will convey that to my authorities.

Back to the Article IV, it is very encouraging to see the wide-ranging socioeconomic reform agenda under the so-called Vision Realization Programs, moving from the design to the implementation stage, which is starting to yield positive results in growth, female labor participation, and non-oil revenue. Having said so, there are still enormous challenges for the authorities.

First, enhancing the governance of public financing is one of the key issues. The discussion of the potential role of fiscal rules in Saudi Arabia in last year's selected issues paper provided a set of options for the fiscal rules of the country. It is worth noting that fiscal transparency is a key prerequisite for any of the fiscal rules to be adopted in the country. I encourage the Saudi authorities to continue their efforts to enhance the fiscal transparency in the future. It is also necessary to enhance the transparency in the Public Investment Fund (PIF). The comparison table on the sovereign wealth fund in Table 8 on page 52 of the paper suggests that there is huge room to improve the transparency of the sovereign wealth fund in Saudi Arabia, compared with their peers.

Second, on the diversification on the basis of industry, it is worth noting that there are ambitious programs across a wide range of sectors, including retail, manufacturing, mining, logistics, tourism, and entertainment, some of which have already been mentioned. We encourage the staff and the authorities to update us on the progress of the implementation of those diversification programs in the coming Article IV reports.

Lastly, on the capital market reforms and the debt management reform, I am quite interested in the very recent progress in this sphere, as the former debt manager of my country. The Debt Management Office published an issuance calendar for domestic debt, extended the yield curve through the issuance of a 30-year *Sukuk*, and established the primary dealer system. These are very positive steps to deepen and to have a well-functioning public debt market, which is the key basis for the entire debt market, the entire capital market. It is especially important for the corporate debt market, which may be the key for corporate finance and corporate growth in the future.

We have very recent experience of establishing the primary dealer system. Only 10 years ago, we extended our yield curve from 10 years to 40 years. I have my own personal experience and lessons to share with you, although we are not a very good provider of the lessons on fiscal consolidation, as all of you know the track record of my country.

In conclusion, I congratulate the authorities on the progress made thus far. I am very happy to hand over the baton of the G20 next year. Having the G20 presidency, much attention is paid to your own country, which will provide good momentum to promote progress in the reform endeavors.

Mr. Rosen made the following statement:

We thank the staff for the well-written and comprehensive Article IV report and the selected issues paper. We appreciated Mr. Mouminah's gray statement and his comments this morning. We are pleased to read that the authorities are committed to their reform agenda under Vision 2030.

We support the authorities' efforts to diversify the economy, boost job creation, and increase the role of the private sector in the economy. Indeed, increasing the private sector's contribution to GDP, from 40 percent in 2018 to 65 percent in 2030 under Vision 2030, is an ambitious and worthy goal.

The Article IV and selected issues papers are appropriately focused on the structural reforms needed to support the authorities' economic objectives. The papers outline the benefits of labor market reforms, as we have talked about extensively today, reducing barriers to private sector activity, improving the business environment, and enhancing financial inclusion, among others. Those steps are crucial to support diversification of the economy and job creation.

We also encourage the authorities to continue to strengthen the fiscal framework, as Mr. Kaizuka mentioned, and enhance fiscal transparency. While transparency is improved, broadening the coverage of fiscal reporting and providing more detailed data on budget projections and outturns can help improve spending efficiency and improve governance. We are encouraged by the new law on public procurement, and we agree with the staff that all government procurement should now be covered by the reforms.

To conclude, we also wish the authorities success on this ambitious reform agenda.

Mr. Castets made the following statement:

I would like to start by thanking staff for the report and for the very useful selected issues paper and Mr. Mouminah and Mr. Alkhareif for their helpful buff statement and introductory remarks. We have published a gray statement, so I will just focus my intervention on a few selected points, starting by underlining that, like Mr. Kaizuka, we feel very encouraged by the progress of the reforms in Saudi Arabia and particularly on revenue diversification but also on public fiscal management. We commend the authorities for their efforts to gradually decrease the exposure of the Saudi economy to oil price variations. We know that it is not an easy challenge. The introduction of a VAT in 2018 is a major step forward. We welcomed it last year, but we want to insist again because we definitely see it as a transformative step.

Budget preparation, transparency, and medium-term planning have also improved. We encourage the authorities to continue on that road. We also share staff's assessment, that a useful benchmark would be to assess fiscal positions through the non-exported oil primary balance to ensure medium-term consistency, intergenerational equity, and to avoid budget procyclicality in the face of oil price volatility, as also recalled by the mission chief today. That said, Saudi Arabia has substantial fiscal buffers, and it is at the beginning of a long journey to implement its ambitious and comprehensive reform plans. We understand the authorities' approach to implement a gradual and socially acceptable fiscal consolidation. We feel that by doing so, probably they will avoid some abrupt adjustments moving forward.

Second, more specifically on the current focus of the authorities' economic diversification, we are glad to see that this process is starting to bear fruit for the Saudi economy, even if we are probably at the beginning of a long journey. The selected issues paper on this topic was insightful. It clearly showed the conditions under which public support and incentives can be beneficial to specific sectors. As many countries in the region are facing this diversification challenge, deepening this work and sharing the lessons learned will probably be very helpful for all the commodity exporters. We encourage staff to keep working on these incredibly important issues.

We know that inclusion remains a challenge in Saudi Arabia—and Mr. Mouminah mentioned it in his own intervention—be it for the youth unemployment but also for female labor participation and unemployment. This could be addressed through efforts on multiple fronts. But we want to highlight that reducing legal and practical barriers to the participation of women in the job market and also ensuring that skills and qualification requirements match the market's need through appropriate initial and vocational training will help, and we saw in Mr. Mouminah's statement that the authorities are working on it.

Finally, increasing the cost competitiveness of Saudi labor in the private sector is a key objective of the authorities that we fully support.

Let me finish by wishing the best to the Saudi authorities for their G20 presidency.

Ms. Mannathoko made the following statement:

We thank Mr. Mouminah and Mr. Alkhareif for their buff statement and staff for their responses to our questions.

We wanted to commend the Saudi authorities on their reform progress so far and the positive outcomes that have been seen. We encourage ongoing efforts to address the various challenges that the authorities have set out to overcome on their way to Vision 2030. We have issued a gray statement, so I will just limit my comments to two points.

First, on fiscal policy, we are of the view that since the economy has just emerged from recession, care is needed with fiscal consolidation at this juncture and it needs to be growth-friendly, so as not to undermine the recovery. In this regard, we join Mr. Castets in our understanding of the caution that was expressed by the authorities.

Second, regarding real exchange rate appreciation, we had asked a question. We just noticed that the staff’s response to our question was focused on the benefits and costs of pegging. I would just to clarify that the question was not really about the exchange rate regime because, like staff, we believe a peg is appropriate and is necessary in this context to contain Dutch disease pressures and to minimize exchange rate volatility. Our comment was just that, since the peg is usually intended to contain real exchange rate appreciation, which can lead to overvaluation, relative to the non-oil sector, and Dutch disease. The question then was about the decision to allow sustained real exchange rate appreciation to occur anyway because normally, with a peg, it is calibrated. You have it so that you can calibrate it to contain real exchange rate appreciation. I know that is not always easy to do, but sometimes policy decisions are made to allow that for various reasons. It was really in that context.

In closing, I would like to commend the authorities again on the progress they have made so far and to wish them success in their reforms toward Vision 2030.

Mr. Psalidopoulos made the following statement:

We thank staff for the comprehensive set of papers and their oral remarks, as well as Mr. Mouminah and Alkhareif for their informative buff statement. We issued a gray statement, where we welcomed the country’s robust economic performance, as well as the authorities' progress and strong commitments.

We believe that the effort of the Saudi authorities to stop relying on their comparative advantage and their efforts to diversify their economy will teach very important lessons in global economic history in the near future. We share the staff's appraisal, but I would like to reiterate a point made in our gray statement relating to staff's projections and referred to by staff this afternoon.

This chair has recalled on several occasions the need for staff to consider consistent strategies and political feasibility when preparing their outlook and estimating their variables. In the case of Saudi Arabia, we noted the different views between staff and the authorities on the medium-term fiscal path. In this context, we agree with the authorities' assessment that staff assumptions may be pessimistic. In any case, we invite staff to engage in a closer dialogue with the authorities in order to avoid, to the extent possible, such differences of opinion going forward.

Mr. Tombini made the following statement:

I thank Mr. Mouminah and Mr. Alkhareif for the helpful buff statement and for today's introduction. I also enjoyed the staff report and selected issues paper. I would like to raise just a few points to complement our statement.

I take note that, while oil remains a predominant driver in the Saudi Arabian economy, growth continues to be buoyed by the non-oil sector and the diversification driver of the economy. The authorities, as other Directors acknowledged this afternoon, have made good progress in their reform agenda. We commend their efforts to further diversify the economy, promote private sector-led growth, create job opportunities, particularly for youth and women, and to strengthen fiscal sustainability and transparency while enhancing financial stability and development.

We are encouraged by the authorities' firm commitment to balance the budget by 2023 and welcome their willingness to implement additional policy measures, if needed, to achieve this goal. Moreover, we take positive note of the implementation of reforms to upgrade fiscal policies and their public financial management (PFM).

While we agree that labor market reforms are essential to increase competitiveness and support inclusive growth, incentivizing employees to work in the private sector is a challenge, given the large economic footprint and the higher wages in the public sector. This notwithstanding, further labor market reforms geared toward closing the productivity wage gap among national workers will be crucial in this endeavor. Furthermore, we note that gender disparity in Saudi Arabia, despite the progress being made in this area, is still very high, including employment opportunities and access to financial services for women. The authorities are encouraged to review their regulatory framework to ensure that there are no impediments for female participation in the labor market, as well as for entrepreneurship.

Finally, the progress made by the authorities, with the disclosure of information, is welcome. We urge them to continue their efforts to enhance transparency in line with international best practices by publishing more detailed budget and spending execution data.

With these remarks, I wish all the best for the Saudi Arabian authorities.

Mr. Inderbinen made the following statement:

We join others in thanking the Acting Chair for his earlier remarks and the staff for their documentation and Mr. Mouminah and Mr. Alkhareif for their helpful buff statement and also Mr. Mouminah for the context that he provided.

In the gray statement, we welcome the sound policies and the reforms pursued by the authorities under the Vision 2030 and also note the progress under the Vision Realization Programs. We also take good note that the authorities intend to retain a close collaboration with Fund staff in moving ahead with their important reform agenda.

We encourage further fiscal consolidation, and we note the differences between staff and the authorities on this aspect. We thank staff for the elaborations that they offered on this.

Like Mr. Kaizuka, Mr. Rosen, and others, we also encourage the authorities to further strengthen fiscal transparency. We welcome the improvement that has already been made, including the publication of the pre-budget statement and the further publications that are envisaged on the mid-year budget updates going forward.

We also thought it was very helpful that Box 3 of the report listed the further possible milestones. This led to a question. Has staff ever discussed the possibility of a Fiscal Transparency Evaluation (FTE) with the authorities? Maybe staff could report on that or provide initial reactions if that was the case.

Further, we are very encouraged by the priority that is given to the public governance and anti-corruption measures by the authorities. The enhancements already made to governance and the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework are positive, but there is room for further improvement. Priority should be given to implementing financial disclosure for public officials and addressing some of the key deficiencies in the AML/CFT framework that have been identified in the mutual evaluation report.

Finally, on the exchange rate, like Mr. Kaya, Mr. Psalidopoulos, and others, we did take good note of the staff's recommendation to keep the peg, given the structure of the economy at the moment, but to keep the peg under review over the medium and long term for the reasons that staff provide in the report.

Mr. Tan made the following statement:

We thank staff for the informative paper and their responses to the technical questions. We also thank Mr. Mouminah for the helpful buff statement and opening remarks. We commend the authorities for the visible progress to date on the reform agenda, implementing recommendations from the last staff reports, keeping the fiscal deficit in check, and promoting non-oil growth, among other things. These are positive signs. We are also encouraged by the impression that there is a broad consensus on the policy objectives, even while there may be some varying views on how to get there. This is to be expected at times. We also note the strong ownership on the part of the authorities, which is commendable, and it is not the case often enough for the Article IV consultations.

We have one general observation and two specific comments to add for emphasis following our gray statement.

First, as the reform agenda moves from design to implementation, we are pleasantly taken by the authorities' readiness to learn from experience and to fine-tune their plans along the way, when warranted by new conditions on the ground, even as they keep the end firmly in mind. This is a sensible approach at this phase of the country's reform journey, as even the best plans do not always go as intended, and getting the reforms right will be more a long game of chess, rather than a quick round of checkers.

That brings me to the first comment around the fiscal outlook. The staff has looked ahead and has recommended a tighter stance to mitigate perceived medium-term fiscal vulnerabilities. The clarifications to the technical questions and opening remarks today were helpful. In our opinion, a lot hinges on the oil price assumptions. While we fully agree with the wisdom of erring on the side of caution, the authorities have argued forcefully their preparedness and commitment to take stock and change course if required. In this regard, their good progress and results to date do lend some weight to their cause.

Taking a step back, this should not obscure us from the broader issue of the procyclicality of government spending. Here, we take good note of staff's analysis, and we see that the authorities are committed to further strengthening expenditure, management, and budgeting. This speaks well for the future. While luck favors the brave, we would encourage the authorities to continue to work closely with staff to deliver on balancing the budget in 2023 and leave nothing to chance. In this regard, we welcome Mr. Mouminah reaffirming that commitment earlier.

The second comment relates to the interesting role of the public sector. Staff's concern on crowding out the private sector is well founded, and the authorities' policy design to crowd in the private sector is well intended. In this context, experience from my constituency shows that economic diversification has to be informed by a deep appreciation of the interdependence between the public and private sectors. First, that public policies should be guided by the application of market principles, such as competitiveness. Getting the economics right has been a hallmark of governance. Second, the private sector needs the public sector, as economic development and diversification does not occur naturally. Preconditions need to be in place, and the public sector needs to create them if these are missing. All this makes good sense in theory. Getting the balance right in practice will be a complex and iterative process to formulate policies around the use of price incentives and market realities as a tool for allocating resources efficiently and avoiding waste.

Before ending, I would also like to join others in supporting the authorities' ongoing efforts to improve data availability and quality and their plan to subscribe to the Special Data Dissemination Standard (SDDS) before end-2019. On that note, we wish the authorities well for the G20 presidency and their future.

Mr. Beblawi made the following statement:

We thank Mr. Mouminah and Mr. Alkhareif for the useful elaboration contained in their buff statement, which highlight the authorities' ambitious reforms and objectives. We also thank staff for their insightful report and for their responses to technical questions.

We commend the Saudi authorities for the progress in implementing their economic and social reform agenda, including the recent introduction of a value-added tax. We note that generally positive outlook is subject to some challenges related to global oil price volatility.

Continued adherence to the authorities' plans to further improve fiscal sustainability and to promote a diverse economy is, therefore, critical to improve resilience and long-term growth prospects. Reforms to support diversification and job creation and the significant investments that are being made all aim to promote new promising sectors as a key driver of growth. The list of reforms mentioned in the buff statement are impressive, and we are already seeing positive results.

We had expressed surprise that productivity growth did not increase in 2018 following the departure of a large number of foreign workers. We thank staff for the explanation that suggests that alternative labor data shows an improvement in productivity growth.

As is stated in our gray statement, we applaud the importance placed by the Saudi authorities on increasing female and youth employment. As elaborated in the buff statement, female labor force participation has continued to rise, partly due to the efforts to promote female entrepreneurship, transportation, and child care assistance programs. The buff statement mentioned the "Women in Business" initiative and 68 new initiatives by the Ministry of Labor and Social Development. With these efforts, we look forward to continued progress in the employment of women and youth in the years to come. We wish continued success to the Saudi authorities in this regard.

Mr. Raghani made the following statement:

I would like to join other colleagues in thanking staff for the set of useful papers and Mr. Mouminah and Mr. Alkhareif for their informative buff statement and Mr. Mouminah for his insightful opening remarks. We have issued a gray statement, and I will limit our remarks to the following points.

Let me first join other Directors in commending the authorities for their remarkable economic and social reform implementation, which has supported the economic recovery and a strong fiscal and external position. The continued implementation of the reform agenda Vision 2030 is, therefore, essential to increase the country's resilience, expand the non-oil sector economy, and create more private sector jobs.

As noted by many colleagues, the authorities should continue with their efforts to maintain fiscal sustainability. In this context, we are reassured by their strong commitments and willingness to deliver the necessary adjustment while protecting the most vulnerable groups in case the oil price turns lower than anticipated.

Finally, the efforts made in implementing structural reforms to diversify the economy are commendable. However, as stressed in some gray statements, we agree that key challenges remain in terms of increasing the scope of private sector activity and employment. We encourage the authorities to redouble their efforts in this regard and to maintain their overall structural reform momentum. We are reassured by the remarkable progress made recently, as highlighted by Mr. Mouminah in his buff statement and his opening remarks.

With these remarks, we wish the authorities all success in their future endeavors.

Ms. McKiernan made the following statement:

I thank staff for the comprehensive report and their responses, both in writing and orally. I thank Mr. Mouminah and Mr. Alkhareif for the helpful buff statement.

Let me just say that the opening remarks by Mr. Mouminah and Mr. Callen gave a picture, which you can never get in words on the page, regarding reforms and momentum. It was really helpful. Some of the remarks I was going to make are now overtaken by those events. But I will just make two comments.

First, with Saudi Arabia about to take over the G20 chair next year, we encourage the authorities to seize this opportunity to collaborate with advanced and emerging members to help accelerate progress on issues that pose risks to the kingdom's economic growth. In that vein, we encourage a robust G20 dialogue on areas related to fiscal transparency, as was also mentioned by Messrs. Kaizuka, Rosen, and Inderbinen, on good governance, and on gender equality.

Second, we commend the authorities and the remarks that you made earlier regarding the implementation of labor market reforms to encourage female employment, including by reducing transportation and child care costs. I was heartened to hear the reforms related to gender equality are described as momentous. Of course, we continue to have concerns regarding gender disparity, but it is good to know that it is going in the right direction. However, there is always a risk that the momentum can falter or slow down. We would encourage a continued focus on that big challenge.

Finally, we support the staff's assessment that regulations be reviewed to ensure that there are no impediments to female employment and business ownership, as was also mentioned by Mr. Tombini.

Mr. Gokarn made the following statement:

We join others in thanking staff for their excellent paper and for the opening remarks today, the Acting Chair for his opening remarks, and Mr. Mouminah and Mr. Alkhareif for both the buff statement and for their very informative opening statement.

We issued a gray statement jointly with Ms. Mahasandana's office, so I will confine myself to one issue, which many people have referred to, which is the diversification policy.

First, let me say that—in a general sense—that this is not the kind of document one would normally associate with Fund publications, advocating industrial policy, but it is important at this juncture. As Mr. Psalidopoulos indicated, it might prove to be a lesson, a model in terms of economic restructuring. Many countries, although in different circumstances, may need this advice more and more. For example, a country in my constituency, Bangladesh, has very different circumstances than Saudi Arabia, but it has, in a sense, locked itself into the ready-made garment sector—80 percent of its exports come from ready-made garments. They are also looking for viable and low-risk methods of diversification. The principles that emerge from this discussion may have a wider applicability.

In terms of the specific recommendations, I have two points. One is about the very important point that was made in the paper about the starting point, the initial conditions. This is a model that one typically associates with low-wage countries with abundant labor supplies. We are talking about private sector wages being an average of US$25,000 dollars and public sector wages being US$35,000. We are now in a very different phase of the trajectory of industrial policy than we were with the comparator countries, the countries that are being cited. I wonder what difference this makes in terms of designs, in terms of understanding the opportunities and the threats, because this is not the set of initial conditions that one would associate with a labor-intensive manufacturing drive, which is, in a sense, the subtext of the note. Some more thinking needs to be done in terms of, when you are trying to enter the highway at an intermediate stage, what is the best way to fit into the traffic?

The second, which is also a very important point, is about discipline, and the mechanisms that countries use to discipline the sectors that were favored in whichever way through policy instruments. The role of exports is given due importance, that the East Asians, in particular, used exports as an objective arm's-length disciplining mechanism to determine whether a sector was succeeding or not, or even companies. Is that an opportunity? Is that a feasible instrument in the Saudi context? That is an important question. The paper does not answer this definitively. It says that discipline is important, but each country has to then find its own mechanism to enforce it. Some more concrete instances of what could be a disciplining mechanism might be useful.

Let me also wish the Saudi Arabian authorities the best for their upcoming presidency.

Mr. Guerra made the following statement:

I join other Directors in thanking Mr. Mouminah and Mr. Alkhareif for the very useful introductory remarks. Like other Directors, we commend the authorities for their broad agenda of structural reforms, which aim to further diversify the economy, promote private sector-led growth, create job opportunities for youth and women, and at the same time, strengthen the fiscal sustainability.

Let me touch upon two points.

My first point has to do with the fiscal stance and the fiscal projections. While understanding and supporting the staff assessment, the country has to have a conservative fiscal stance. We fully acknowledge and support the authorities' commitment to meet the medium-term fiscal targets, irrespective of the future path of oil prices. It is clear that the authorities can flexibly—while being mindful of the impact on growth—choose to implement the necessary fiscal policies in order to secure the fiscal targets in the medium term. In this, we have liked that the fiscal position has continued to improve recently. As an example of this commitment to fiscal prudence, we cite the successful introduction of the VAT reform. Like other Directors, we note that there is the necessity to strengthen fiscal transparency, as presented in the staff appraisal.

We also commend the authorities for their recent improvements in economic data. I want to highlight and commend the authorities' determination to subscribe to the Special Data Dissemination Standards (SDDS) before the end of the year, as reported in Mr. Mouminah and Mr. Alkhareif's buff statement.

Last but not least, we also wish the authorities success in their future endeavors and a lot of success in their presidency. They will have our full support.

The staff representative from the Middle East and Central Asia Department (Mr. Callen), in response to further questions and comments from Executive Directors, made the following additional statement:

Maybe I can take the easy question first on the FTE, where there have been discussions between the authorities and the Fiscal Affairs Department (FAD). We are hoping that an evaluation will go ahead possibly later this year. The authorities, themselves, are very keen and see that as a good way of seeing the progress they have made and also the next steps they would need to take.

I just wanted to touch on a few comments in terms of fiscal adjustment in the political and social environment, which are very important. I want to go back a couple of years, where staff on a number of occasions suggested a slower pace of fiscal adjustment than the government had in their initial fiscal balance program. For exactly these reasons, we thought there was not a need to rush the fiscal adjustment. It would be costly to growth, and we advised a slower pace of adjustment. Now, our view is that the pendulum has swung somewhat too much in the other direction, which is why now we are calling for a somewhat faster pace. But I wanted to put this advice in the long-term perspective of what we have called for over the last few years.

On the real exchange rate appreciation, the peg to the dollar has meant, basically, the nominal and the real exchange rate have pretty much moved in train. There have been very few periods in Saudi Arabia where the inflation rate has differed substantially from the United States—maybe the mid-2000s. In our view, there clearly are concerns that if the dollar and the oil price are moving reasonably together, then you are probably going to get a real exchange rate that is moving with the terms of trade. That has not happened in the last few years. That is one of the contexts for why you want to evaluate the pegged exchange rate from time to time to see if it is providing the right outcomes.

Of course, I can point to costs of the peg. There are also benefits which are quite strong. My guess is, if you had a different type of exchange rate regime, you probably would not have seen that real appreciation in the last few years, but there would have been other costs of a different exchange rate regime that you would have to balance out. That is how we would broadly think about it. Plus, we find—and some of this work was updated in the Oman Article IV that was recently discussed at the Board—that if you look at external adjustment, it is very hard to find a significant role for the real exchange rate. It is basically all fiscal policy in most of these countries.

Lastly on diversification, you have touched on some very important issues. We have to be incredibly humble in this area because a lot of it is, as Mr. Tan said, probably country-specific. In Saudi Arabia, I would point to two things. There are certainly areas where you can get diversification in the labor force where it may be more traditional. Certainly, they are not low-income, but maybe middle-income professions. The retail trade is a prime example in Saudi Arabia, where probably less than 20 percent of people working in the retail sector are Saudis. Most of them are expatriates. There are ways that by cost competitiveness adjustment, you could maybe get more Saudis into those areas. But then there is the question of: How do you get into some of the industries that Saudi Arabia is looking to get into through its National Industrial Development and Logistics Program? There, the issues are going to be much tougher in terms of, how do you get both the skills of the labor force up in those areas and have them at wages that will be competitive in international market.

We have pointed out some of the problems. We have offered some of the solutions that other countries have looked at. On whether all of those are applicable in the case of Saudi Arabia, I agree that it needs further work, and it is certainly an area we can continue to look at.

Mr. Mouminah made the following concluding statement:

I will start by thanking Directors for their thoughtful comments, expressed in both their gray statements and in today’s discussion. We feel humbled to hear all the interventions. I will convey Directors’ comments and helpful suggestions to my authorities. Reflecting on the discussion today, I would just highlight a few points.

I want to reaffirm my authorities’ intention to stay within the envelope and to reach a fiscal balance by 2023. This is striking the right balance between spending and incentivizing growth versus making sure that you stay within the discipline. This is an extremely difficult formula to achieve, however, it is always on their minds. We do not want to get into a slowdown. Hence the approach. We are very much aware of most of the concerns that were raised because of that.

Going from the public sector-led growth to private-sector led growth, we believe it is a journey, and it cannot be happening all of a sudden. We are very committed to it. That is why we are trying to remove all impediments from a regulatory environment, from an incentives perspective, to the private sector, making sure that they lead the growth and move the growth from being dependent on government expenditures, and as staff says, public spending still has a big footprint.

On diversification, we will look at the suggestion by staff. We will have a very good discussion because it is a very unique recommendation on how to move into diversification. We take it, and we really appreciate it.

The last point is on the G20 agenda for women. I want to reaffirm the point that was raised. Female employment and inclusion will be on the top of the agenda points that the Saudi presidency will take under its belt.

To conclude, I thank Mr. Callen and his team for the excellent work they have done and for the constructive policy discussions during the Article IV mission. My authorities greatly value the constructive recommendations by the Fund, as can be seen from the implementation of most of the staff’s recommendations laid out in last year’s Article IV report and the 2017 Financial Sector Assessment Program (FSAP) report as well. Indeed, they will continue to take into consideration staff’s recommendations as they continue the implementation of their economic and social reform agenda.

The Acting Chair (Mr. Zhang) noted that Saudi Arabia is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the progress in implementing their economic and social reform agenda, including the introduction of the value-added tax and energy price reforms. Directors noted that reforms have started to yield results and that the outlook for the economy is positive; however, volatility in global oil prices poses uncertainty. They emphasized that continued commitment to prudent macroeconomic policies and appropriate prioritization of reforms will be key to promoting non-oil growth, creating jobs for nationals, and achieving the objectives of the authorities' Vision 2030 agenda.

Directors underscored that fiscal consolidation is key to rebuilding fiscal buffers and reducing medium-term fiscal vulnerabilities. They encouraged the authorities to build on their fiscal reforms, including by continuing with the planned energy and water price reforms and increases in expatriate labor fees. Directors considered that additional fiscal measures would also be needed and highlighted that containing the government wage bill and a more measured increase in capital spending could yield fiscal savings. They also acknowledged that the authorities have committed to introduce further fiscal measures if needed.

Directors encouraged the authorities to continue to improve expenditure management and strengthen the fiscal framework, noting that, despite important reforms, spending has increased. They welcomed reforms to strengthen public procurement, which will help improve the efficiency of government spending and reduce the risks of corruption in procurement. Directors welcomed the efforts to enhance fiscal transparency. However, they considered that publishing more detailed budget and spending execution data would further increase fiscal transparency and viewed a robust asset-liability management framework as essential to guide analysis of the public sector balance sheet, cash flows, and risk/return tradeoffs.

Directors welcomed the authorities' ambitious reforms to develop the non-oil economy. They noted the ongoing efforts to strengthen the business environment and considered that careful implementation of industrial policies could encourage the development of new sectors of the economy. Directors emphasized that any government support should be made available at the sectoral level, be time bound, and have strict performance criteria attached.

Directors considered that policies to develop new economic sectors will be successful if Saudi workers have the needed skills for the private sector and the incentives to offer them at competitive wages. They emphasized the need to ensure that wages and productivity are well aligned and that labor market policies should focus on setting clear expectations about the limited employment prospects in the public sector, strengthening education and training, and increasing female employment.

Directors underscored that reforms should be inclusive and vulnerable households protected from any negative effects. They welcomed the review of social assistance programs to ensure they provide adequate support to those in need and are well targeted.

Directors welcomed the continued resilience of the financial sector and ongoing capital market reforms. They agreed that the development of agency banking and Fintech could help broaden the channels of financial access. Directors agreed that improving financial access for young and growing companies, women, and youth are important, but emphasized that specific sector lending targets should be avoided. They welcomed Saudi Arabia's ongoing strengthening of the AML/CFT framework and its recent membership of the Financial Action Task Force.

Directors agreed that given the current structure of the economy, the exchange rate peg to the U.S. dollar continues to serve the economy well.

Directors emphasized that further improving the quality and availability of data is important and were encouraged by the authorities' commitment to subscribe to the Fund's SDDS by the end of the year.

It is expected that the next Article IV consultation with Saudi Arabia will be held on the standard 12-month cycle.

APPROVAL: May 26, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Growth and Productivity

1. ***We would appreciate it if staff elaborates on the main differences between their growth projections and those of the authorities, who envisage higher growth.***

- The authorities have not published their real GDP growth projections, but have indicated that they believe that growth will be higher than forecast by staff. They expect non-oil growth to pick up faster than in staff's baseline as they believe the ongoing reforms will yield larger dividends.

- Recently released real GDP data for 2019Q1 and the announced extension of the OPEC+ agreement are broadly consistent with the staff's growth forecast for 2019. Real GDP growth slowed as expected in 2019Q1 to 1.7 percent (y/y) from 3.6 percent (y/y) in 2018Q4. Real oil GDP growth slowed to 1 percent (y/y) in 2019Q1 from 6 percent (y/y) in 2018Q4 in line with lower oil production under the OPEC+ agreement. Real non-oil GDP growth picked up slightly in 2019Q1 to 2.1 percent (y/y) from 2 percent in 2018Q4, although this increase was somewhat less than projected in the baseline in the staff report. Staff had assumed that the OPEC+ agreement would be extended to the second half of 2019 in its projections.

2. ***We would welcome staff's comments on the extent the oil price risk could be mitigated by the production decision of Saudi Arabia itself? What is the oil production cost of Saudi Arabia compared to its peers?***

- Saudi Arabia has spare production capacity and has shown its ability to increase or reduce oil production quickly. Saudi Arabia's production capacity is around 12 mb/d and its current production is 9.8 mb/d.

- What matters for the fiscal and external position is the combination of prices and quantities. While it is certainly true that Saudi Arabia has some influence on the global oil market, it depends on how its production decisions (when combined with those of other producing nations) affects prices. Staff provides estimates in footnote 4 on page 10 of the staff report of how changes in prices and quantities affect the budget position.

- Oil production costs in Saudi Arabia are among the lowest in the world. ARAMCO issued a bond prospectus earlier this year disclosing that the average cost of production is $2.8 a barrel ($7.5 a barrel including capital expenditures).

3. ***We would welcome an explanation of why we don't see a pickup in TFP growth with the pickup in non-oil growth.***

4. ***Do staff have a sense of what exactly caused the structural break in TFP around 2011? Do staff have specific recommendations for the authorities on how to overcome this contraction?***

- Productivity declined across countries at all income levels following the global financial crisis, in part due to the impact of elevated economic and policy uncertainty on the composition of investment (see for example "Gone with the Headwinds: Global Productivity," SDN 17/04).

- In the case of Saudi Arabia, we believe that TFP was boosted during the early to mid-2000s by reforms at the time of the country's WTO accession in 2005, higher FDI, and targeted government investment in infrastructure. During 2010-2014, however, the government expanded public sector employment and capital expenditures. Some of these expenditures were inefficient, which led to a decline in TFP.

- Measuring TFP growth in the last couple of years is complicated by problems with the employment data. In the calculations in Appendix II, staff uses the employment series generated from the Labor Force Survey (LFS) for which a longer time series is available. As explained in paragraph 7 of the Appendix, if the data from the private pension fund and the Ministry of Civil Service is used, it would likely show a pickup in TFP in 2018 given the large drop in expatriate employment. However, this data is only available from late 2016 and hence cannot be used in the analysis.

- To strengthen TFP, staff recommends that the authorities focus on product and labor market reforms and investments in human capital and innovation. In this regard, removing barriers to entry and enhancing economic competition, increasing FDI, improving education and training, increasing the mobility of expatriate workers, and incentivizing Saudis to work outside the government are all important.

Fiscal Policy

5. ***We would appreciate staff elaborating on the differences in oil price assumptions between the Fund and the authorities.***

6. ***Can staff further discuss the factors behind the divergence in oil price assumptions and the impact on the fiscal outturns going forward?***

7. ***We would like to ask staff's view on the authorities' oil price projections and whether the authorities have any fiscal rules or legislations that ensure spending restraint in case of lower than expected oil prices to achieve fiscal targets.***

- As is standard at the Fund, the team uses the WEO oil price baseline (the simple average of Brent, Dubai, and West Texas) in its projections. This baseline is derived from financial market prices. The WEO price baseline is then adjusted if necessary for any historical differences between this price and the average Saudi export price. The oil price used in the staff projections is shown in Tables 1 and 4 of the staff report.

- The authorities believe that oil prices will be higher over the medium term than those used by staff. They do not, however, publish or disclose to staff the oil price path that underlies their budget projections.

- The authorities' revenue projections are higher than those of staff during 2021-23. Staff believes this is due to higher assumed oil revenues. Everything else remaining unchanged, an oil price of $72 a barrel (compared to $57.6 a barrel in the staff's baseline) would be needed to equalize the staff's and authorities' revenue projection in 2023.

- The are no fiscal rules or legislation, although the authorities have announced a target of balancing the budget by 2023 and the Fiscal Balance Program (FBP) aims to avoid government debt exceeding 30 percent of GDP.

- Reform efforts have focused so far on strengthening the fiscal framework, including strengthening the budget process, developing a medium-term fiscal framework, launching the online expenditure management system (Etimad), and enhancing fiscal transparency. Staff views these efforts as appropriate as they are a prerequisite for success of any fiscal rule that the authorities may consider adopting in the future. The potential role of fiscal rules in Saudi Arabia was discussed in a Selected Issues paper last year.

8. ***Could staff elaborate on the assumptions underlying the medium-term projections and how they compare with the authorities' intentions?***

9. ***Could staff elaborate further on these differences of opinion [on the government expenditure path], including with respect to the projections for oil prices, which the authorities regard as pessimistic?***

- Staff baseline projections reflect our best estimates of the impact of the government's revenue and expenditure measures/policies as outlined in the Fiscal Balance Program and subsequent updates and the 2019 Budget. Oil prices are consistent with the WEO oil price baseline and the OPEC+ agreement is assumed to continue to end-2019 (an extension to end-2020Q1 has recently been announced). Thereafter, oil production and exports are expected to increase. Energy price reforms and further increases in the expatriate levy are assumed to proceed as announced, while revenues from the settlement agreements continue in 2019 and 2020.

- The staff projects that government spending will be broadly unchanged as a share of GDP and decline as a share of non-oil GDP (from 56 to 50 percent) between 2018 and 2024. The path of capital spending is broadly the same in the staff baseline and the authorities' projections, but the current spending path is higher in staff's baseline mainly reflecting stronger assumed growth in the wage bill and purchases of goods and services. Given that the expenditure overrun (relative to budget) over the past 3 years has averaged 9 percent, staff has built in an assumed overrun in 2019 (of 6 percent). Staff also assumes that the cost of living allowances decreed by King Salman in January 2018 will expire as planned at end-2019.

- The authorities' medium-term fiscal projections show higher revenues and lower spending relative to staff projections. The differences between staff's and authorities' projections are shown in the text chart in paragraph 10 of the staff report.

10. ***Could staff elaborate on the budget flexibility in Saudi Arabia, particularly with respect to the extent to which planned expenditures can be postponed or cancelled?***

- There is scope to increase capital spending more slowly than envisaged in the budget so this does provide some flexibility. Of course, this would have some impact on growth and would slow the implementation of the Vision Realization Programs. This flexibility, however, is less helpful than in 2014 given that capital spending is now lower. The Spending Efficiency Realization Center is continuing to work on eliminating spending inefficiencies which could provide further budgetary room, while allowing the cost of living allowances to expire at end-2019 as planned would also free up fiscal space.

11. ***We invite staff's elaboration on the strength of such commitment [to implement contingency measures].***

12. ***What are staff views on the details of the contingency plan? Is there scope to reach consensus with the authorities in lieu of investment spending cuts?***

- The authorities reiterated to staff their commitment to balancing the budget by 2023 as indicated in paragraph 22 of the staff report. They said that they stand ready to contain the wage bill and spread out capital spending over a longer period, postpone non-priority spending, and consider additional revenue measures if needed to achieve their fiscal objectives.

- Staff believes that it is important to start implementing such measures gradually from 2020 rather than waiting for oil prices to drop and then adjusting more sharply. A gradual adjustment will reduce the procyclicality of spending and strengthen fiscal buffers.

- Staff believes that a range of additional revenue and expenditure measures can be implemented to achieve additional fiscal consolidation as set out in paragraph 20 of the staff report.

13. ***Could staff elaborate how the suggested additional fiscal measures would support stronger growth over the medium-term?***

- Staff believes that additional fiscal consolidation efforts now will provide greater insurance against the risks of a sharp drop in oil prices in the future. While staff acknowledges that there will be some adverse effect on growth in the near term, it will help strengthen fiscal buffers and thereby reduce fiscal vulnerabilities in the future. Stronger fiscal buffers will avoid the need for larger spending cuts in case of a decline in oil prices. A stronger fiscal position will provide greater certainty to domestic and foreign investors in terms of the path of government spending which in turn should encourage private investment.

- Targeting a non-exported oil fiscal deficit as suggested in the staff report will help anchor spending in a medium-term framework and reduce spending procyclicality. Again, this would provide greater certainty to the private sector.

14. ***Staff views on the timing and expected magnitudes of downward wage bill adjustments under the authorities' wage bill reduction plan are welcome.***

- The 2019 budget projected a decline in the nominal wage bill of 1 percent a year during 2019-21. Staff's understanding is that this would be achieved by a reduced headcount (as not all retirees are replaced), the replacement of other retirees with more junior staff who earn less, and some adjustment of allowances.

- The authorities conducted a civil service review with the assistance of the World Bank and are working on a strategy to improve the civil service structure and ensure efficient delivery of public services. Civil service reforms should include a review of allowances and benefits such as leave and aim to bring the pay scale in line with productivity.

- In the staff's baseline, the wage bill is projected to decline in 2020 following the expiration of the 2018 Royal Decree allowances and then to grow in line with inflation over the coming years. No increase in the headcount is incorporated in the baseline.

15. ***We note the authorities' concern with staff's fiscal outlook. Staff's comments are welcome on the budget surplus in 2019Q1, the additional policy levers at the authorities' disposal, and the substantial financial assets available beyond the budgetary central government.***

- The budget surplus in 2019Q1 reflects a larger increase in oil and non-oil revenues and a more moderate increase in spending relative to 2018Q1. The surplus in the first quarter is certainly encouraging, but in staff's view it is too early to predict how this will impact the fiscal outcome for the rest of the year given the volatility in oil revenues and the fact that spending in the first quarter of the year usually accounts for only around 20 percent of annual budget spending. Indeed, over the past two years, around one-third of annual spending has occurred in the fourth quarter.

- Staff believes that the authorities do have additional policy levers available to them on both the revenue and expenditure side of the budget. These are set out in paragraph 20 of the staff report. In staff's view, it would be better to gradually introduce these measures to achieve some additional fiscal consolidation rather than wait and have to adjust fiscal policy more abruptly if oil prices fall.

- The authorities do have substantial financial assets available beyond government deposits at SAMA. However, it is not clear to staff how big these assets are nor how liquid they are. Information is not disclosed to make such an assessment possible. It is also important to remember that there are potential future liabilities outside the central government including in the pension system. Further, large investment commitments are being made by the PIF and Aramco that are outside the central government that will need to be financed.

16. ***Are the proceeds from settlement agreements one-off revenues or are they expected to continue as a major source of revenue in coming years?***

- Staff understands from the authorities that proceeds from the settlement agreements will be around 1.7 percent of GDP in 2019 and 2020, After that, no additional proceeds are assumed in the budget. This path is built into the staff's baseline.

17. ***What is the authorities projected date for reaching non-oil fiscal balance?***

- The authorities have targeted to reach an overall budget balance by 2023. They have not set a target to achieve non-oil fiscal balance. Staff believes that there is no need to achieve non-oil fiscal balance, but has suggested that over the long term the authorities move the fiscal position to one that is consistent with intergenerational equity.

18. ***In staff view, are there any issues other than the PIF's current transition from cash to accrual accounting that may delay consolidating fiscal reporting?***

- In addition to ongoing efforts to improve and institutionalize fiscal reporting of the central government budget, the authorities have started to take steps to enhance the financial transparency of public corporations. The recent publication of ARAMCO's bond prospectus is a good step in this direction.

- Beyond these reforms, little information is available to staff on progress in other areas. Consolidation will become easier once the central government has moved to accrual accounting (which is already the case for ARAMCO and will be soon for the PIF). That said, given the large size of the public corporations in Saudi Arabia, it is likely to take time for the government to be in position to provide consolidated fiscal reporting of the public sector.

The Exchange Rate and Monetary Policy

19. ***We wonder whether a more flexible exchange rate will be more suitable in the near future given the overall objectives of the Vision 2030 strategy. Staff comments are welcome.***

- At this time, we believe that the focus of the Vision 2030 strategy should be on continuing to implement structural reforms to boost the competitiveness of the economy rather than reforms to the exchange rate.

- The staff believes that the peg remains the best exchange rate option for Saudi Arabia given the current structure of the economy. A move away from the peg would remove a credible nominal anchor, increase uncertainty, and have limited benefits for competitiveness in the near term. Indeed, if the exchange rate were to depreciate significantly, the loss of real incomes for the domestic population could significantly undermine the government's ability to implement its reform agenda.

20. ***Can staff elaborate on how they are advising the authorities with regards to the sustained real exchange rate appreciation?***

- There are definitely costs and benefits of pegging to the U.S. dollar. On balance, staff believes that the benefits of the peg outweigh the costs.

- One of the costs of the peg is that the real exchange rate has appreciated at a time when the terms of trade have declined with the fall in oil prices. However, staff's empirical analysis suggests that the real exchange rate has a limited impact on the external sector position in countries such as Saudi Arabia that are heavily dependent on oil. External adjustment is mainly driven by fiscal policy.

- Staff's advice has therefore been to maintain the exchange rate peg, adjust fiscal policy to ensure fiscal and external sustainability, and implement structural reforms and labor market reforms to improve the competitiveness of the tradeables sector. Over time, as these reforms begin to diversify the economy, the appropriateness of the peg should be reviewed.

21. ***We would like staff to comment on the effectiveness of the established liquidity forecasting framework to guide money market operations and maintain monetary stability***.

- After the tightening of liquidity in 2016 due to the decline in oil prices and government payment delays, SAMA started to strengthen its liquidity forecasting and management frameworks with support of technical assistance from MCM.

- SAMA is now producing weekly liquidity forecasts to guide its monetary operations. Staff has advised SAMA to develop daily liquidity forecasts and has welcomed the strengthened coordination between SAMA and the DMO. Since 2016, liquidity in the banking sector has improved and become comfortable and interest rate volatility has declined so the strength of the new framework has yet to be fully tested.

22. ***Can staff elaborate on the optimal monetary policy stance in a hypothetical scenario where inflation dynamics between the U.S. and Saudi Arabia diverge materially?***

- Staff would want to first understand what is driving the divergence in inflation dynamics. It could be very specific factors such as the current decline in housing rents or more generalized. Also, if lower inflation in Saudi Arabia is driven by supply side factors such as improved competitiveness of labor, staff would not be concerned. If lower inflation were, however, driven by persistent and generalized weakness in demand, there would be a case for a policy response.

- Staff sees fiscal policy as the most effective demand management tool and would first look at options for adjusting the fiscal stance and/or the composition of fiscal adjustment, taking into account fiscal policy space. It would then turn to SAMA policy.

- SAMA's policy rate is constrained by the peg and has usually followed closely U.S. policy rates. SAMA has other policy instruments beyond its policy interest rates that it can use to influence inflation and growth. These include reserve requirements, liquid asset ratios, debt service ratios, and sector-specific instruments such as the loan-to-value ratio for mortgage lending. Consideration would need to be given to whether these instruments should be adjusted.

Financial Sector

23. ***On the NPL ratio, which edged up to 2 percent in 2018Q4 though the ratio remains low, could staff elaborate on the cause of the increase and whether there are specific sectors that the NPL is increasing?***

- No sectoral breakdown of NPLs is published for the banking sector as a whole. From individual banks' financial statements, it can be seen that NPLs vary significantly across sectors. In 2017, NPLs in the construction sector were highest while personal loans had very low NPL rates. In 2018, little disaggregated data is yet available, but for the country's largest bank, which has provided a sectoral breakdown, NPLs for corporate lending increased.

24. ***We would ask staff to comment on the recent increase in mortgage lending amidst the decline in real estate prices.***

- Mortgage lending has been growing strongly, although it remains a relatively small share of bank credit. Further, the average LTV is comfortably below SAMA's limit, and risks are reduced by the salary-assignment of loans (allowing lenders to directly deduct mortgage payments from paychecks) and government guarantees on a large share of new mortgages.

- SAMA believes that risks from the mortgage sector are extremely low, but is closely monitoring mortgage lending. It has recently fined a number of financial institutions for violating responsible lending policies (debt-service limits). Staff encouraged SAMA to continue to closely monitor the quality of real estate lending.

25. ***Could staff comment on the adequacy of supervision of Islamic banking activities?***

- The 2017 FSSA found that SAMA has taken major steps to enhance the prudential oversight of all banks, consistent with best practice.

- One of the recommendations from the 2017 FSSA was to provide banks with guidance on how to map the risk profiles of Islamic products to the Basel framework. SAMA has developed such guidelines in consultation with banks and is currently finalizing them.

26. ***On the primary dealer system, we would like to ask whether foreign institutions can be a primary dealer, which would help internationalization of the bond market.***

27. ***We invite staff to comment on the impact of the introduction of a primary dealer system and the extension of the government yield curve to long-dated maturities to increase private sector investments and activities in the domestic debt market.***

- Five banks with domestic licenses have been appointed as primary dealers. Some of these banks have their own international operations or are structured as joint ventures with foreign banks. Staff is not aware of restrictions on the ability of foreign banks to negotiate primary dealer agreements with the Ministry of Finance.

- The primary dealer system will over time support the functioning and development of the government debt market by increasing liquidity and price discovery. The extension of the government yield curve will provide both a benchmark for private sector issuers and offer an alternative saving vehicle which may be particularly useful for pension funds and insurance companies.

28. ***Could staff elaborate on plans [to deepen domestic financial markets]?***

- The Capital Market Authority (CMA) has recently announced a further liberalization of foreign ownership rules for listed Saudi companies. Specifically, non-financial companies will be allowed to invest in the equity market and foreign investors will be allowed to take controlling stakes in listed companies (under current rules, foreign investors have to be large financial firms and foreign ownership is capped at 49 percent).

- The CMA has also announced plans to launch a derivatives market by the end of 2019, starting with the introduction of futures contracts. This is intended to broaden the options available to investors and facilitate risk management.

29. ***Does staff estimate that there is a financial inclusion issue in Saudi Arabia (regarding SMEs or new firms)?***

- Financial inclusion of SMEs as measured by the share of loans to the sector is quite low in Saudi Arabia, an issue recognized by the government. While it is not clear whether the low share of SME lending is due to demand or supply issues, the authorities are taking steps to boost lending to SMEs. The government has increased the capital of Kafalah, the credit guarantee program, provided indirect funding of SAR 1.6 billion to investment institutions other than banks, and established a Venture Capital fund of SAR 2.8 billion to broaden funding sources for SMEs. These initiatives as well as reforms to the legal framework and business environment will support a bigger role for innovative new firms.

- Banks are being encouraged to lend to SMEs and have been asked by SAMA to establish dedicated departments to handle SME lending and support. In this regard, staff advised against setting lending targets for specific sectors which SAMA emphasized they are not doing.

Structural Reforms

30. ***On the involvement of private sectors, could staff elaborate more on how the authorities' industrial policies incentivize private companies to enter new or riskier sectors and the role of the PIF in this context?***

- The National Industrial Development and Logistics Program, one of the Vision Realization Programs to implement Vision 2030, outlines a comprehensive set of incentives for the private sector, including loans for up to 75 percent of invested capital, equity investments, tax incentives, export financing through the new Exim bank, as well as subsidies as large as 15 percent of value added for car manufacturers.

- The PIF is supporting mega projects including NEOM, Red Sea, and Qiddiya. In addition, it is seeking to support the localization of technology and know-how by launching new sectors, as well as through strategic partnerships with global partners. It expects to invest SAR 210 billion (7 percent of GDP) over the coming three years in advanced technology and research and development, locally and internationally.

31. ***We would like to hear staff's views on promising sectors of the country.***

- The authorities are implementing ambitious programs across a wide range of sectors. As Box 1 in the Selected Issues Paper explains, their priority sectors include retail, manufacturing, mining, logistics, tourism, and entertainment.

- While staff are not experts in any of these sectors, there is definitely potential in them. Staff has suggested that policies to develop these sectors will be most successful if education and training are strengthened, and Saudi workers have the incentives to offer their skills at competitive wages. It is also important that any government support is extended at the sectoral level with strict performance criteria attached.

- Lastly, other GCC countries are developing or are already well established in some of these sectors and cooperation and coordination across countries may prove beneficial.

32. ***We welcome staff's elaboration on the current situation of NEOM project and its possible impact on fiscal viability?***

- The implementation of the NEOM project is at an early stage. A company has been formed by the PIF with some initial funding and a management team identified, and infrastructure construction is expected to ramp up this year and next. The first commercial flight into the NEOM airport recently took place.

- NEOM and the other giga-projects (including Red Sea and Qiddiya) aim to draw significant public and private investments. Success with attracting the expected level of private investment will be important for fiscal sustainability going forward given the large cost of the development that is estimated at $500 billion.

33. ***In staff's view, will 2022 be sufficient to ensure the achievement of Vision 2030 goals?***

- The current set of VRPs is intended to begin moving Saudi Arabia towards the goals of Vision 2030, but is not expected to be the only wave. While staff assumes that government investment in the VRPs peaks in 2022, investment will continue thereafter, and the government expects to draw in increasing private investment after it has made initial investments.

- As the staff appraisal notes, the ambitious reform program is most likely to succeed with appropriate prioritization, a careful balance between fiscal sustainability and growth, and a package of policies that ensures Saudi workers have the skills in demand in the private sector and the incentives to offer them at competitive wages.

34. ***Could staff give an update on the authorities' progress to adopt and implement new laws on competition, franchise, and insolvency, as well as on implementation of the anti-corruption measures and their near- and long-term growth effects?***

- The Bankruptcy Law came into effect in August 2018 and several cases are currently in progress. The updated Competition Law was approved by the Council of Ministers in March 2019, and the legislative process associated with the Franchise Law is ongoing. Staff estimates that structural reforms could raise non-oil growth by

0.25 percentage points a year in the medium term, although the range of uncertainty around this estimate is large (see the 2018 Staff Report).

- The new public procurement law should improve the efficiency of government spending and reduce the risks of corruption. A senior official has previously indicated that corruption in procurement may have cost 5-10 percent of government spending in some years prior to 2014. Progress with the anti-corruption measures includes the adoption of a new anti-corruption strategy, the elimination of the statute of limitations for current and former ministers, and the acquisition of powers by the Public Prosecutor to prosecute foreign corrupt acts in Saudi Arabia.

- Saudi Arabia was granted full membership to the Financial Action Task Force (FATF) on June 21, 2019. Saudi Arabia has been working to implement an action plan to address key AML/CFT effectiveness issues identified in its 2018 evaluation report. Membership was granted based on the country's commitment to complete the items on its action plan and on continuing progress to improve its AML/CFT regime.

- As noted in the 2018 Staff Report (Box 7), if corruption indicators in Saudi Arabia moved to the average level observed in advanced economies, this could raise real GDP growth by 0.5-1 percent. It is challenging to pin down the speed with which this growth could be realized, as well as the extent to which it might persist in the long term.

Labor Market Reforms

35. ***We would welcome staff comments on the costs and benefits [of the Saudization strategy], with sizable fiscal revenues, but possible detrimental impacts on the operations of businesses.***

36. ***Could staff comment on the findings of IMF or World Bank empirical analysis of the outcome of these labor market reform measures? Can staff share their views on alternative reform models considered in the quest to normalize the structure of the Saudi labor market?***

- The Saudization strategy (the levy on expatriate workers and the quota system, Nitaqat) aims to modify the tradeoff employers perceive between hiring expatriate and Saudi workers, by narrowing the wage gap or mandating a certain level of Saudi employment. The expatriate levy, when fully implemented, is expected to close about one-fifth of the average wage gap between Saudi and expatriate workers in the private sector. Staff therefore believes that additional reforms focused on increased mobility of expatriate workers will be needed.

- Beyond closing the wage gap between expatriate workers and Saudis, policies should target two additional objectives. First, closing the gap between wages and productivity for Saudi workers. Second, creating an environment in which Saudis have incentives to pursue private sector employment.

- It should be noted that the government has now opened its new foreign residency program. An online portal has been launched through which applicants can apply for two types of visa/residency programs. The first is for unlimited duration residency and the second is for a renewable annual residency program. The residency program allows free movement between jobs and the ability to own property and conduct business in the country in line with the foreign investment laws. The program is aimed at attracting high-skilled workers and investors to Saudi Arabia.

- The departure of expatriates due to the expatriate levy has weighed on consumption, inflation, remittance outflows, and the real estate market. Staff estimates that this departure may have reduced real GDP growth by about ½-¾ percentage points in 2018.

37. ***We welcome staff's elaboration on how wage subsidies for Saudis might fit within a sustainable fiscal envelope if combined with other fiscal reforms?***

- The government has some wage subsidy programs currently in place, funded by the Human Resource Development Fund. These could be expanded without expanding the overall fiscal envelope (or perhaps while even shrinking it) if government wages and benefits were simultaneously reduced.

38. ***Who bears the cost [of the expatriate levy], the firm or the employee, or is it shared? And to what extent has the levy effectively narrowed the public-private wage gap?***

- It is not clear who is bearing the cost of the levy, but we think it is likely mainly falling on firms. Firms initially pay the levy and there is no evidence that expatriate wages have adjusted.

- A Selected Issues Paper assessing labor market policies last year presented scenarios on the likely impact based on whether expatriates or firms bear the cost of the levy. If workers were to bear the cost, little change in employment should occur, while if the expat levy raises costs for firms, and firms view Saudis as sufficiently productive to replace expatriates, firms will substitute expatriate workers for Saudis.

39. ***Staff comments on the progress with policies to increase female labor force participation since the last Article IV report would be appreciated.***

40. ***We would welcome staff comments on possible future reform initiatives for female employment and entrepreneurship.***

41. ***Could staff provide additional information on the impact of the envisaged reforms [on the gender gap and youth unemployment]?***

- Progress has been made in three areas since the 2018 Staff Report. First, programs to subsidize transportation and childcare costs for lower income women have been expanded. Second, women have been permitted to drive since June 2018. Third, more positions in government are being created to address gender issues. For example, the Ministry of Civil Service has recently appointed a Deputy Minister for Women's Empowerment.

- Beyond reviewing all regulations to ensure there are no impediments to female employment, additional programs could be created for female entrepreneurs under SME initiatives, and existing programs to subsidize transportation and childcare costs could be expanded as needed. Help could also be made available to businesses to reconfigure work spaces to accommodate women in line with social norms if this is needed.

- Greater financial inclusion of women, including through digital banking and financial literacy programs, is likely to go hand-in-hand with stronger female labor force participation and increased entrepreneurship.

- One of the primary motivations for diversifying the Saudi economy is the need to create jobs, particularly for females and youth. Indeed, there is considerable overlap between women and youth unemployment. Many young women have entered the labor market in recent years, but not all have found jobs. Expansion of programs to subsidize transportation costs for women and childcare could have a role to play as well. Lastly, given social customs and norms, it is likely that increased female participation and employment will be a gradual process.

- More generally, addressing structural issues such as the gap between wages and productivity will be crucial to create private sector jobs for females and youth. Improving the quality of education and training can help improve productivity and contribute towards closing this gap over time.