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June 27, 1984

To: Members of the Executive Board
From: The Acting Secretary
Subject: Saudi Arabia - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Saudi Arabia.

It is proposed to bring this subject to the agenda for discussion on Wednesday, July 25, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. von Post (ext. 76412) or Mr. Iqbal (ext. 76477).

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INTERNATIONAL MONETARY FUND

SAUDI ARABIA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Article IV Consultation with Saudi Arabia

Approved by A.S. Shaalan and Subimal Mookerjee

June 27, 1984

I. Introduction

The 1984 Article IV consultation discussions with Saudi Arabia were held in Riyadh during the period April 28-May 1, 1984. The Saudi Arabian representatives were led by H.E. Sheikh Hamad Al-Sayari, the Acting Governor of the Saudi Arabian Monetary Agency (SAMA), and included senior officials of the Government. The mission was composed of Messrs. A.S. Shaalan (Head), B.A. Karamali, D. Noursi, and S. von Post, and Ms. C. Nicholson (Secretary), all of MED. Mr. J.E. Suraisry, Alternate Executive Director for Saudi Arabia, attended the meetings.

Saudi Arabia accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement on March 22, 1961.

II. Recent Developments

Economic and financial developments in Saudi Arabia in recent years have been importantly affected by the variations in oil receipts, which have accounted for nearly all of the country's export earnings and almost 85 percent of budgetary revenue during the past five years. Because of the sustained decline in world oil consumption, a significant drawdown of global inventories, and increases in output of some other producers, Saudi Arabia's annual crude oil production fell sharply from a high level of almost 10 million barrels a day (mbd) in 1980 and 1981 to 6.5 mbd in 1982 and an estimated 5 mbd in 1983, the lowest annual level since 1971. With the restoration of stability in the oil market following the agreement reached by the members of OPEC in mid-March 1983 (to reduce the price of oil and to introduce production ceilings) and a moderate upturn in oil consumption of the industrial countries in the second half of 1983, Saudi Arabia's production recovered significantly from the low point of about 4 mbd reached in the first quarter of the year. This recovery was followed by a moderate decline in late 1983 and in the first quarter of 1984 (to less than 5 mbd) which resulted partly from a temporary shutdown of a few fields for technical reasons and from a renewed drawdown of oil inventories, although on a much smaller scale

than during the first quarter of 1983. Saudi Arabia's average oil export price continued to rise slightly in 1982 but declined significantly in 1983 because of the 15 percent price reduction agreed upon at the OPEC meeting early in the year. The value of oil exports (in U.S. dollars) fell by about 60 percent from 1981 to 1983 and budgetary oil revenue declined by a slightly larger percentage over the past two fiscal years (ended April 1, 1984).

The steep decline in oil revenue led to a marked adjustment in the fiscal policy stance. Although the adjustment was facilitated by the completion of major infrastructural projects, the authorities exercised considerable restraint on government spending. As a result, the strong upward trend in public sector spending for several years up to 1981/82 was reversed in the following two fiscal years when total budgetary expenditures recorded a cumulative decline of more than 20 percent. This decline was achieved mainly by a reduction in development expenditures, which reflected in part the postponement of some new projects and a reduction in advance payments to contractors in 1982/83. While maintenance expenditures for completed projects increased, there was a significant curtailment of other current outlays (especially in 1983/84) stemming from the implementation of a number of expenditure control measures and some reductions in direct subsidies. In addition, budgetary foreign aid disbursements (which do not include all of Saudi Arabia's assistance to developing countries) and transfers to specialized credit institutions declined from the high levels in 1981/82. Notwithstanding the fall in expenditures and a significant increase in domestic revenue, the overall budgetary position shifted from a large surplus in 1981/82 to near balance in 1982/83 and a sizable deficit in 1983/84 because of the sharp decline in oil revenue.

The marked adjustment of the stance of fiscal policy during the past two years toward restraint on government spending led to a dampening of economic activity in the non-oil sector. Growth in real non-oil GDP slowed from an average of almost 12 percent per annum in the three years 1979/80-1981/82 to little over 7 percent in 1982/83 and an estimated 5 percent in 1983/84. The slowdown in economic activity was reflected mainly in the construction sector. Growth in the still relatively small industrial sector was maintained at a high level and agricultural output increased substantially in response to strong incentives provided by the Government.

The increase in commercial bank credit to the private sector has been relatively moderate during the past few years reflecting mainly the general slowdown of economic activity and the weakening of import demand. Moreover, the major part of private sector credit needs has continued to be met by the specialized credit institutions (on highly concessional terms), particularly for investments in industry, agriculture, and residential housing. In 1983/84, bank credit to the private sector rose at a faster rate than in the preceding year reflecting to a large extent increased credit demand by contractors following the reduction in advance

payments on government projects. Nevertheless, with the fall in government net domestic spending, the expansion of broad money, which had already decelerated from an annual average of 25 percent in 1979/80-1981/82 to 12.5 percent in 1982/83, continued to slow to an estimated 4-5 percent in 1983/84 (complete monetary data are available only for the first five months of the year).

A greatly improved supply situation following the elimination of earlier constraints--affecting particularly the flow of imports--and the pursuit of a liberal policy with respect to foreign workers, contributed to the containment of inflation in Saudi Arabia during the past several years. With the slowdown of economic activity and liquidity expansion, coupled with a decline in riyal import prices resulting from the effective appreciation of the riyal and the reduced rate of price increases abroad, inflation moderated further during the past two years. The rate of increase in the non-oil GDP deflator, which had averaged 7 percent during 1979/80-1981/82, declined to 4 percent in 1982/83. The cost of living index advanced at an even slower pace during the past few years. Both these measures of inflation indicate that domestic prices were virtually stable in 1983/84.

The decline in oil export earnings from a peak of US\$111 billion in 1981 to US\$45 billion in 1983--stemming mainly from the fall in export volume--led to a major turnaround in the balance of payments position. Despite a weakening of import demand since the latter part of 1982 and a further rise in investment income, the current account (excluding foreign aid) shifted from a surplus of US\$44 billion in 1981 to near balance in 1982 and to a deficit of about US\$14 billion in 1983; including foreign aid, the deficit amounted to more than US\$18 billion in 1983. Total official foreign assets held by SAMA (including foreign assets which are not classified as reserves) declined by US\$16 billion in 1983, following an increase totaling US\$75 billion during the three preceding years. Such assets amounted to about US\$128 billion in September 1983 (the latest month for which actual data are available).

Saudi Arabia maintains no restrictions on payments and transfers for international transactions and does not impose restrictions on imports for balance of payments reasons. Since September 1975, the Saudi Arabian riyal has been pegged to the SDR at a rate of SRls 4.28255 = SDR 1, with margins of 7.25 percent on either side. However, the margins have been suspended temporarily since July 1981. While the riyal has been depreciated moderately against the U.S. dollar, the intervention currency, in small steps on several occasions during the past three years, it appreciated significantly against most other currencies. The latest adjustment in the riyal/dollar exchange rate took place on June 6, 1984 when the midpoint of the official buying and selling rates was set at SRls 3.505 per US\$1. From the end of 1980 through June 6, 1984, the riyal depreciated by about 5 percent against the U.S. dollar and appreciated by about 15.5 percent against the SDR. The riyal registered a nominal effective appreciation of 24 percent from the end of 1980 through April 30, 1984; over the same period, the riyal appreciated in real effective terms by about 1 percent.

Although some improvements have been made in the range and quality of economic and financial statistics in recent years, the analysis of developments in Saudi Arabia's economy continues to be hampered by insufficient information in some areas and the lack of currentness of certain important statistical series. A significant problem in the assessment of monetary developments is that the balance sheet of SAMA--incorporating data on total official foreign assets--is available with a considerable delay. ^{1/} Balance of payments statistics are available only in an aggregate form, while data on the petroleum sector are available with varying time lags. Saudi Arabia's national accounts statistics, although fairly comprehensive, would benefit from a revision of the constant price series by using more current weights (the base year is presently 1969/70). The cost of living indices, on the other hand, have been improved considerably in recent years and are currently available with a minimum time lag. Improvements have also been made in foreign trade statistics. The Saudi Arabian authorities are cognizant of the data problems and are taking steps to eliminate them. For instance, with a view to improving their national accounts statistics, the authorities have in recent years availed themselves of technical assistance from the United Nations and the Fund.

III. Policies and Prospects

1. The petroleum sector

Saudi Arabia's policies with respect to oil production and prices are guided by long-term considerations and are aimed at, inter alia, promoting stable conditions and a unified price structure in the world oil market, providing adequate supplies of oil to meet the requirements of consuming countries, and safeguarding and preserving the future value of the country's large oil reserves (estimated at about one fourth of the world's total). In accordance with these objectives, the authorities have pursued a flexible production policy and have consistently adhered to the announced official selling prices. The high level of production maintained during most of the period 1979-81 served to contain the upward pressure on oil prices and facilitated the unification of the oil price structure in October 1981. Since that time, Saudi Arabia has absorbed a major part of the decline in world oil demand by allowing its output to fall very steeply. Under the March 1983 OPEC agreement, Saudi Arabia was designated as the "swing" producer to "supply the balancing quantities to meet market requirements."

The Saudi Arabian representatives noted that the effective implementation of the OPEC agreement had restored orderly and stable market conditions, thereby serving the interests of both producers and

^{1/} These delays largely stem from the fact that while SAMA closes its books at the end of the Hijri year, the government accounts are closed after the end of the fiscal year, i.e., at the midpoint of the Hijri year. SAMA is unable to finalize its balance sheet until the public sector accounts are closed.

consumers of oil. They said that Saudi Arabia would continue to adhere to the agreement and that the level of its crude oil production would, as in the past, be dictated by conditions in the oil market. With regard to the short-term outlook, the Saudi Arabian representatives felt that, in view of the strengthening of economic activity in importing countries, the demand for OPEC oil would increase moderately in 1984 and 1985 and that Saudi Arabia's annual production level, as a result, might be expected to increase somewhat from the low level in 1983; the revenue estimates in the budget for 1984/85 were based on a production level of 5.3 mbd. They stressed, however, the unusually large margin of error inherent in any projection of Saudi Arabia's output, given the country's role as swing producer and the uncertainties surrounding prospective demand for oil at the present juncture. With respect to oil prices, the Saudi Arabian representatives felt that, in view of the relatively moderate pace of recovery in total oil demand so far and expected for the near future, it would be desirable if the present nominal price was maintained for some time, probably at least through the end of 1985. They also said that Saudi Arabia would support the present price in the event of any unanticipated market developments leading to pressure on prices.

Saudi Arabia is currently in the process of substantially expanding its crude oil refining capacity which should result in a large rise in exports of refined products during the next two years. The refined products will be sold at prevailing market prices and the Saudi Arabian representatives did not foresee any significant marketing difficulties or any adverse influence on the oil market arising out of these sales. With regard to crude oil marketing, a small portion of Saudi Arabia's exports has been sold, on a temporary basis, on a spot or short-term basis through new marketing channels since the latter part of 1983. Such sales, which are all made at the announced official selling prices and under the same terms (i.e., with 30 days' credit) as other crude oil exports, were intended to provide increased production and marketing flexibility and to gain more direct access to information on short-term developments in the oil market, thereby enabling Saudi Arabia to carry out its swing producer function more effectively. Saudi Arabia has also been accumulating limited amounts of crude oil for storage outside the country since the latter part of 1983. This buildup of stocks had occurred primarily for technical reasons, viz., to ensure that sufficient amounts of associated gas and of various grades of crude oil would be available during periods when the production rates of particular oil fields changed or during temporary shutdowns of certain fields.

One of the major development undertakings in Saudi Arabia in recent years has been the implementation of the Master Gas System, which aims at exploiting most of the gas produced in association with crude oil as fuel or feedstock for petrochemical and other industries as well as for public utilities, and to provide large quantities of natural gas liquids for export. The availability of associated gas (for both domestic needs

and exports) was, however, reduced somewhat during the past two years because of the large drop in crude oil production. The dependence on crude oil production for the availability of gas is expected to be reduced substantially within the next year or two because of three main developments. First, additional associated gas is expected to become available as fields producing medium and heavier crude oils are being tied into the gas system. Second, in order to improve the flexibility in utilizing Saudi Arabia's crude oil and gas resources, several industrial plants and utilities are being designed for dual-fuel capability. Third, and of perhaps greater significance in the longer term, is the development of nonassociated gas resources from deep reservoirs. The first such supply of gas is expected to become available in late 1984 or in 1985.

2. Financial policies, non-oil output, and prices

Given the structure of Saudi Arabia's economy, government use of the large financial resources generated in the petroleum sector is the primary determinant of economic activity in the non-oil sector and of domestic liquidity expansion. The reductions in budgetary expenditures of 14 percent in 1982/83 and 9 percent in 1983/84, following annual increases averaging almost 25 percent in the three preceding fiscal years, represented a marked adjustment of the fiscal policy stance that was influenced primarily by the sharp drop in oil revenue. The adjustment has entailed a substantial effort on the part of the authorities to reduce less essential outlays and to introduce economies and tighter control mechanisms over the whole spectrum of government outlays. Among the specific measures taken were restrictions on the filling of vacancies in the civil service, a freeze on new positions, tighter control of allowances and benefits, and some reduction in the amount of direct subsidies. The successful curtailment of expenditures was accompanied by increased efforts to raise additional revenue from domestic sources, mainly through improved collection methods, through expanded receipts from various government services, and through an increase in the minimum rate of customs duties from 3 percent to 4 percent in the middle of 1983/84. ^{1/} Even though delays in introducing some planned new revenue measures led to a shortfall from the 1983/84 budget estimates, domestic revenue (i.e., excluding oil and investment income) increased by more than 90 percent from 1981/82 to 1983/84. Nevertheless, such revenue remained relatively small, being equivalent to about 9 percent of total revenue and approximately 8 percent of non-oil GDP in 1983/84.

Budgetary plans for 1984/85 (April 2, 1984-March 22, 1985) indicate some easing of the restraint on government spending of the past two years and an intensification of efforts to raise domestic revenue. Although expenditures in the current year's budget are set at the same level as in the 1983/84 budget (SR1s 260 billion), the rate of implementation is

^{1/} This increase was implemented in conformity with a decision of the members of the Gulf Cooperation Council (GCC) to harmonize customs duties in member countries within a range of 4 percent to 20 percent.

expected to be higher this year 1/ because of the initiation of more new projects--mostly of a smaller scale and in the areas of education, health, and rural development--and some increase in the size of the civil service following the freeze on new hiring last year. Despite an estimated decline in investment income (associated with the fall in official foreign assets), the 1984/85 budget provides for an increase in total revenue of about 12 percent, reflecting a rise in oil revenue of about 18 percent over the provisional actuals for 1983/84 2/ and a 60 percent expansion of domestic revenue. The latter increase is to be realized mainly from further improvements in revenue collections, from the coming into operation of additional revenue-producing public sector enterprises, and from the introduction of some new revenue measures, the most important of which is a tax on domestically sold petroleum products which effectively raised prices of these products by about 70-100 percent at the beginning of the fiscal year. Overall, the 1984/85 budget provides for a deficit of SRls 46 billion (US\$13 billion), compared to the provisional actual deficit of SRls 33 billion in 1983/84.

The easing of the restraint on government spending in the current fiscal year is intended partly to avoid any further reduction in real growth of the non-oil economy. A full utilization of budgetary expenditure allocations could lead to an increase in real non-oil GDP of about 7 percent. Although the rate of monetary expansion may exceed the modest pace of 1983/84, the noninflationary environment is expected to be maintained in view of the comfortable supply situation. A small increase in the domestic price level is, however, expected in the current fiscal year partly in view of an anticipated rise in import prices and the effects of the recent reductions in direct subsidies.

Although monetary and credit policy has been of limited importance as an instrument of demand management, it has played an important role by encouraging the orderly development of a sound commercial banking system. While the number of banks has remained small, their operations have expanded substantially in recent years with a rapid growth in deposits, a large rise in the number of branches, and a strengthening of the capital base. The increase in claims on the private sector, however, has not kept pace with the expansion of the banks' deposit base because of the limited domestic investment opportunities, the high volume of credit extended by the specialized credit institutions, and the recent slowdown of economic activity. It is expected that commercial bank lending to the private sector will grow in importance as new investment opportunities develop and as the banks expand the scope of their lending, which so far has been concentrated in trade financing and other short-term credit.

1/ Actual expenditures in 1982/83 and 1983/84 fell short of budgetary allocations by about 22 percent and 14 percent, respectively.

2/ This increase is larger than the estimated increase in oil production. Budgetary oil revenue is not closely correlated to oil production in the same fiscal year, because of timing differences and other factors.

The large increase in liquid funds available to the commercial banks contributed to a substantial buildup of their foreign assets and led to the maintenance of a high ratio of foreign assets to total assets (approaching 50 percent in the past two years). In February 1984, a new facility (the "Banking Security Deposit Account") was introduced under which commercial banks could place funds with SAMA in the form of 91-day book-entry deposits at a predetermined discount rate (generally somewhat below the comparable rate in the Bahrain market). The deposits cannot be rediscounted but are transferable among banks. Eleven weekly tenders had been issued through the end of April 1984, with total subscriptions estimated at about SRls 3-4 billion, equivalent to about 3 percent of total bank deposits. The new facility was intended mainly to provide the commercial banks with a new domestic investment outlet in local currency, thereby helping to reduce (or reverse) the buildup of their foreign assets. Although the facility is not intended to be used as an instrument of credit and liquidity control at the present time, the authorities believe that it could evolve into a useful monetary tool.

3. Development policies

The emphasis of Saudi Arabia's development program has changed significantly in the recent past and this change is likely to continue during the period of the Fourth Five-Year Plan (starting in March 1985). As the basic infrastructure building program is now virtually completed, particularly the major turnkey projects in the transportation sector, increased priority is being accorded to investments in health, education, and other social services, to the development of small towns and rural areas, and to an expansion of the non-oil commodity-producing sectors. The general guidelines announced for the Fourth Plan indicate that increased emphasis will be given to economic criteria and cost-efficiency in all government programs and to the efficient operation and maintenance of completed projects.

With the growth impulses emanating from public sector operations henceforth expected to be considerably smaller than in the 1970s and early 1980s, one of the major objectives of the development strategy is to enhance the role of the private sector in the development process and to create conditions fostering self-sustained growth in this sector. With an adequate physical infrastructure in place and with the construction of large petrochemical and other basic industries in the new industrial cities of Jubail and Yanbu nearing completion, the authorities believe that the stage has been set for a major expansion of private sector investments in secondary and ancillary industries with appropriate support from the public sector. The necessary capital for such an expansion would be available as the substantial financial resources of the private sector would be complemented by continued large loan disbursements by the specialized credit institutions and by a broadening of the lending activities of the commercial banks. The authorities also believe that the progress made in the strengthening of regional economic cooperation among the members of the GCC, together

with Saudi Arabia's good relations with other developing countries, should help to ensure that markets will be available for new export products.

Some additional measures have been taken during the past two years to make domestic private investments more attractive, including the provision that foreign contractors must subcontract at least 30 percent of government contracts to Saudi Arabian companies. It is also intended to transfer the ownership of major public sector enterprises and some utilities to the private sector. As an initial step in this direction, 30 percent of the equity capital of the Saudi Basic Industries Corporation (SABIC)--the entity responsible for the petrochemical and other large-scale public sector industries--was recently offered for sale to the private sector. A National Industrialization Company (NIC) is being established with participation of SABIC, other public sector institutions, and major commercial banks. Although it is organized as a private company, the NIC is expected to act as a catalyst for private industrial investment by establishing medium-size enterprises in partnership with Saudi Arabian and foreign companies, by taking minority equity stakes in new or existing companies, and by providing management and other services to such enterprises.

The staff representatives observed that the emphasis placed on expanding the role of the private sector was appropriate at this stage of Saudi Arabia's economic development. Care should be taken, however, to ensure that the incentives provided to the private sector did not encourage investments in enterprises that would be dependent, to at least some extent, on permanent subsidies or protection in some form. The Saudi Arabian representatives emphasized that the intention of the authorities was to ensure that only viable and productive enterprises were supported and that the free market environment was maintained. Protection from imports would continue to be provided only in the form of selective tariff protection (limited both in size and duration) and no reliance on quantitative restrictions was contemplated. The system of subsidies was to be rationalized to ensure that inefficient industries were not promoted and to reduce the burden on the budget. Some direct subsidies (e.g., on food items and agricultural inputs) had already been reduced or eliminated during the past two years. A review of the prices charged by public utilities and for government services was under way in coordination with other members of the GCC. Although the Saudi Arabian representatives believed that some indirect subsidies (such as the granting of interest-free loans to private enterprises) would continue to be warranted during the initial stages because of unusual start-up difficulties or potential external economies, they stressed that all investments considered for government-supported loans were reviewed extensively to ensure not only that normal criteria of profitability were being fully met but also that the project conformed with overall development objectives such as providing for a minimum value added per worker.

In line with the objective of the Government to increase the participation of Saudi Arabian nationals in the labor force, strong emphasis is currently being placed on manpower training at all levels.

Although most new positions, as a result, are now being filled by nationals, the Saudi Arabian representatives said that certain sectors of the economy would need additional foreign workers for some time. Nevertheless, with more nationals entering the labor force and with the construction sector (the major employer of foreign workers so far) declining in relative importance, the total number of expatriate workers might have begun to decline slightly.

4. The external sector

Saudi Arabia's near-term balance of payments outlook remains uncertain because of the potentially large variability of oil export earnings. However, in view of the limited prospects for a major upturn in world oil demand, it appears likely that the external payments position will not show any substantial improvement during 1984 and 1985, even with the maintenance of generally restrained demand management policies. Although new export earnings are emerging from the petrochemical industries that are now coming on stream, such earnings are expected to make only a moderate contribution to the balance of payments in the next few years.

The authorities' projection for 1984 indicates that the current account deficit will remain virtually unchanged (at about US\$14 billion) from the level in 1983, as a moderate recovery in oil export earnings (resulting entirely from a rise in volume) is expected to be offset by small increases in imports and in net invisible payments. Although the projection is based on the assumption that expenditure appropriations in the 1984/85 budget would be fully utilized, the value of imports (in U.S. dollars) is expected to increase by only 2 percent as the expansionary impact on import demand of the upturn in government spending is likely to be gradual and may be accompanied by some further reduction in stocks. The growth in imports is expected to be moderate also because of the probable slight decline in the size of the expatriate labor force and the further rise in import-substituting production. Although invisible payments are projected to remain virtually unchanged, a decline in investment income is expected to lead to a small increase in the deficit on the services and private transfers account. With a moderate net inflow of private capital and a decline in net foreign assets of the commercial banks, the fall in official foreign assets in 1984 is projected to be smaller (about US\$10 billion) than in 1983.

The staff representatives noted that imports could be somewhat lower than projected if government expenditures were to fall significantly short of the budgeted level. Although it is difficult at this time to make a realistic projection beyond 1984, given the uncertainties in the international oil market and the fact that the Fourth Plan (to be initiated early in 1985) is still under preparation, some moderate improvement in the balance of payments position may be expected for 1985 on the assumptions that oil exports will increase further and that demand management policy will continue to be relatively restrained.

Saudi Arabia has provided generous amounts of concessional economic assistance to other developing countries in recent years and such aid declined only moderately in the past two years, despite the large drop in oil export receipts. As a percentage of total current account earnings, foreign aid, in fact, increased significantly from 1981 to 1983. Total foreign aid disbursements in 1984 are expected to remain at approximately the 1983 level.

The Saudi Arabian representatives confirmed that reserve management policy continued to be guided mainly by considerations relating to the safety of placements, liquidity, and the rate of return. The liquidity aspect had assumed growing importance in view of Saudi Arabia's role as the "swing" producer of crude oil. The authorities had always been mindful of the interests of the international community in managing their foreign assets. While some geographical and currency diversification of assets had taken place, such diversification had been effected in a balanced and gradual manner and without large or sudden shifts of assets between currencies.

The Saudi Arabian representatives said the major objective of exchange rate policy continued to be to maintain a relatively stable relationship with respect to major currencies. In view of the substantial appreciation of the U.S. dollar in recent years, the Saudi Arabian riyal has been depreciated vis-a-vis the U.S. dollar on several occasions. The recent small changes in the riyal/U.S. dollar rate were also aimed partly at introducing an element of uncertainty in the market so as to discourage speculative flows. In response to a question by the staff representatives whether any consideration had been given to using exchange rate policy over the medium term as a general instrument to encourage investments by the private sector in import-competing and export-oriented industries, the Saudi Arabian representatives said that this was a matter to be considered at a later date.

IV. Staff Appraisal

The performance of the Saudi Arabian economy during the past several years has been impressive. The authorities have succeeded over a span of only one decade to construct a modern and adequate infrastructure. The non-oil sector expanded at the exceptionally high average annual rate of about 12.5 percent in real terms during the period. Following the successful elimination of earlier supply constraints, this rapid growth has taken place in an environment of moderate inflation. The highly responsible policies pursued by the authorities with respect to oil production and pricing tended to mitigate the adverse effects of the unsettled conditions in the international oil market in 1979-81 and contributed importantly to the restoration of stability in this market in 1983.

Economic and financial management has recently been made more difficult by the steep decline in oil revenue and by the potentially large variability of such revenue that Saudi Arabia's role as the swing

producer of crude oil entails. The authorities are to be commended for their remarkable flexibility in adjusting the fiscal policy stance. Although the adjustment was facilitated by the completion of major infrastructural projects, the restraint on government spending involved a considerable effort on the part of the authorities to streamline expenditures and to curtail less essential outlays. In addition, an important beginning was made to diversify the revenue base. The success of the policies pursued during the past two years is attested by the fact that non-oil economic growth, although moderating significantly from the exceptionally rapid rate of a few years earlier, has been maintained at a satisfactory level. Moreover, Saudi Arabia experienced no increase in the domestic price level in 1983/84.

In the present circumstances, some easing of the restraint on government spending, as embodied in the authorities' budgetary plans for 1984/85, appears justified. The increase in expenditures should, however, be moderate and tailored to realistic revenue expectations over the medium term. The staff encourages the authorities to continue their efforts to diversify the revenue base and to improve the cost-efficiency of government projects and programs.

The staff welcomes the current emphasis placed by the authorities on enhancing the role of the private sector in supporting the development effort. It must be ensured, however, that growth in the private sector is oriented toward viable and productive undertakings. In this respect, the current policy of upgrading the skills of the national labor force, while maintaining a flexible policy toward foreign labor, and the intention of the authorities to review and rationalize the existing system of subsidies are highly appropriate. Although some degree of official support to the private sector may be necessary for some time, it will be important to continue avoiding excessive protection and permanent subsidies. The authorities are fully cognizant of these concerns and are determined to prevent inefficiencies in resource use. The staff believes that consideration should also be given, at the appropriate time, to the use of exchange rate policy to encourage further diversification of the economy.

Saudi Arabia's current account deficit in 1984 is expected to remain at approximately the same level as in 1983 and a further substantial drawdown of official foreign assets is anticipated this year. The total decline in such assets estimated for 1983-84 is equivalent to about one third of the corresponding gain during the three preceding years and should not be cause for serious concern given the comfortable level of foreign assets.

Saudi Arabia maintains no exchange restrictions and does not impose trade restrictions on imports for balance of payments reasons. The Saudi Arabian authorities have continued to pursue responsible reserve management policies. They have also demonstrated their strong support for the Fund by the provision of substantial resources for the enlarged

access facility and through their commitment under the GAB. The authorities deserve to be complimented for their continued generous program of providing assistance to developing countries.

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

Saudi Arabia: Fund Relations

(As of May 31, 1984)

I. Membership Status

Date of membership: August 26, 1957

Status: Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota	SDR 3,202.4 million
(b) Total Fund holdings of Saudi Arabian riyals	SDR 1,135.3 million or 35.5 percent of quota
(c) Fund credit	None
(d) Reserve tranche position	SDR 2,067.1 million
(e) Current operational budget (maximum use of currency)	SDR 114.1 million (transfers) SDR 48.9 million (receipts)

	<u>Limits</u>	<u>Outstanding</u>	<u>Uncalled</u>
	<u>(In millions of SDRs)</u>		
(f) Lending to the Fund:			
GAB (associated agreement)	1,500	--	1,500
Oil facility	2,250	--	--
SFF	1,934	1,956.7 ^{1/}	27
Enlarged access	11,000	5,700.0	5,300

III. Saudi Arabia has not used Fund resources to date.

IV. SDR Department

Net cumulative allocation	SDR 195.5 million
Holdings	SDR 569.6 million, equivalent to 291.3 percent of net cumulative allocations
Current Designation Plan	SDR 27.5 million

V. Administered Accounts

Subsidy account donations	
Oil facility	SDR 40 million
SFF	SDR 52 million

^{1/} Includes claims transferred from Deutsche Bundesbank.

B. Nonfinancial Relations

- VI. Exchange Rate Arrangement Since September 1975 the exchange rate of the Saudi Arabian riyal has been pegged to the SDR at the rate of SRls 4.28255 = SDR 1, with margins of 7.25 percent. Since mid-1981 observance of these margins has been temporarily suspended. The midpoint between the buying and selling rates for the riyal against the U.S. dollar is SRls 3.505 = US\$1.
- VII. Last Article IV Consultation June 1983; the Staff Report (SM/83/168) was discussed by the Executive Board (EBM/83/224) on August 29, 1983. The summing up indicated that the next Article IV consultation would be held on the standard 12-month cycle.
- VIII. Technical Assistance Since 1975 the Fund has provided Saudi Arabia with seven prebudget technical assistance studies, the latest of which was prepared by the mission that visited Saudi Arabia in November 1983. The last pre-budget study was updated by a staff mission that visited Riyadh in March 1984. A staff team visited Riyadh in June 1981 to assist SAMA staff in establishing an in-house capability for economic modeling and simulation. In conjunction with the 1982 pre-budget study mission, the staff also provided technical assistance to SAMA staff aimed at establishing computer programs for compilation of certain statistical series. The CBD provided the services of an advisor on national accounts for two months in early 1983. A technical assistance mission visited Saudi Arabia during April-May 1984 to assist the authorities in developing statistical table formats designed to enable the authorities to monitor and analyze economic and financial developments.

Saudi Arabia - Basic Data

Area 2.24 million square kilometers
Population (1982 estimate--IFS) 9.7 million

Fiscal years 1/ 1977/78 1978/79 1979/80 1980/81 1981/82 1982/83 Prel.
1983/84

(In percent)

Annual changes in output
and prices

Non-oil GDP at constant
(1969/70) prices

Government sector

Private sector

14.5	11.2	11.8	12.4	11.2	7.2	5.0
(13.5)	(13.2)	(10.1)	(13.8)	(8.1)	(-1.1)	(-1.9)
(15.0)	(10.2)	(12.7)	(11.8)	(12.8)	(11.2)	(8.0)

Implicit non-oil GDP
deflator

16.0	7.3	9.1	6.8	5.3	4.0	--
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Cost of living index 2/

11.3	11.2	1.8	4.2	2.8	1.0	0.3
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(In billions of Saudi Arabian riyals)

Government finances

Revenue

Oil revenue

Investment income

Other revenue

<u>130.7</u>	<u>131.5</u>	<u>211.2</u>	<u>348.1</u>	<u>368.0</u>	<u>246.2</u>	<u>190.7</u>
114.0	115.1	189.3	319.3	328.6	186.0	128.1
11.7	10.0	14.7	21.4	30.2	48.0	45.0
5.0	6.4	7.2	7.4	9.2	12.2	17.6

Expenditure

Current expenditure

Project expenditure

<u>138.0</u>	<u>148.0</u>	<u>188.4</u>	<u>236.6</u>	<u>284.6</u>	<u>244.9</u>	<u>223.2</u>
71.4	71.0	83.9	113.5	138.9	119.2	110.5
66.6	77.0	104.5	123.1	145.7	125.7	112.7 <u>3/</u>

Surplus or deficit (-)

(In percent of GDP

in current prices)

<u>-7.3</u>	<u>-16.5</u>	<u>22.8</u>	<u>111.5</u>	<u>83.4</u>	<u>1.3</u>	<u>-32.5</u>
(3.3)	(6.7)	(5.9)	(21.5)	(16.0)	(0.3)	(8.0)

Memorandum item:

Public sector expenditure
on cash basis 4/

145.1	147.0	178.4	229.6	267.2	252.4	226.4
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Saudi Arabia - Basic Data (Continued)

	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	<u>5 Months</u> <u>1983/84</u>	<u>5/</u>
<u>(In billions of Saudi Arabian riyals)</u>								
Factors affecting monetary expansion								
1. Changes in foreign assets (net)	2.4	-18.2	45.9	135.1	124.5	22.8	-23.3	
2. Changes in public sector deposits (increase-)	14.4	15.5	-32.8	-118.5	-100.8	6.2	16.9	
3. Credit to private sector	2.8	8.5	9.5	11.0	6.3	2.8	6.8	
4. Other items (net)	-3.3	1.9	-9.3	-14.4	1.5	-16.8	0.8	
5. Government net domestic expenditures	94.4	95.3	126.6	139.7	168.7	169.1	...	
6. Private sector balance of payments position	-77.6	-98.0	-113.5	-123.1	-145.0	-140.1	...	
7. Change in money and quasi-money <u>6/</u> (In percent per annum)	16.3 (43.6)	7.8 (14.5)	13.4 (21.8)	13.1 (17.5)	31.5 (35.9)	15.0 (12.5)	1.2 (0.9)	

(In billions of U.S. dollars)

Foreign assets (net) of banking system (end of period)	<u>61.1</u>	<u>58.2</u>	<u>72.1</u>	<u>112.0</u>	<u>146.6</u>	<u>151.0</u>	<u>142.8</u>
Foreign assets of SAMA	58.2	56.1	66.7	102.3	133.1	133.4	127.8
Net foreign assets of commercial banks	2.9	2.1	5.4	9.7	13.5	17.6	15.0
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>Est.</u> <u>1983</u>

(In millions of barrels per day)

Crude oil output	9.20	8.30	9.53	9.90	9.82	6.48	5.00
In percent of:							
OPEC output	(29.3)	(27.5)	(30.7)	(36.4)	(42.5)	(33.9)	(27.7)
World output	(14.8)	(13.2)	(14.6)	(15.9)	(16.7)	(11.6)	(9.0)

Saudi Arabia - Basic Data (Concluded)

	1977	1978	1979	1980	1981	1982	Prel. 1983	Proj. 1984
(In billions of U.S. dollars)								
Balance of payments 7/								
Exports, f.o.b.	40.2	37.0	58.1	100.8	111.2	73.1	45.4	48.6
Of which: oil exports	(40.1)	(36.9)	(57.9)	(100.6)	(111.0)	(72.9)	(44.9)	(47.6)
Imports, f.o.b.	-12.4	-17.2	-20.7	-25.6	-29.9	-34.5	-33.4	-34.1
Services and private transfers (net)	-12.8	-16.5	-21.8	-27.8	-37.2	-35.3	-26.2	-28.4
Receipts	(6.1)	(6.5)	(7.7)	(11.3)	(16.3)	(19.0)	(21.1)	(19.5)
Payments	(-18.9)	(-23.0)	(-29.5)	(-39.1)	(-53.5)	(-54.3)	(-47.3)	(-47.9)
Goods, services, and private transfers	<u>15.0</u>	<u>3.3</u>	<u>15.6</u>	<u>47.3</u>	<u>44.1</u>	<u>3.3</u>	<u>-14.3</u>	<u>-14.0</u>
Official foreign aid	-3.1	-5.5	-4.6	-5.9	-5.7	-4.4	-4.1	-3.7
Goods, services, private transfers, and official foreign aid	<u>11.9</u>	<u>-2.2</u>	<u>11.0</u>	<u>41.4</u>	<u>38.4</u>	<u>-1.1</u>	<u>-18.4</u>	<u>-17.7</u>
Other capital movements and reserves	<u>-11.9</u>	<u>2.2</u>	<u>-11.0</u>	<u>-41.4</u>	<u>-38.4</u>	<u>1.1</u>	<u>18.4</u>	<u>17.7</u>
Oil sector capital transactions (net) and other inward direct investment capital	0.8	0.6	-1.4	-3.2	6.4	11.1	3.7	3.1
Other private capital and errors and omissions	-1.5	0.9	-7.6	-8.3	-0.1	3.4	-0.9	2.5
Commercial banks (net)	-0.7	-0.6	-1.6	-3.7	-6.3	-3.1	-0.2	2.0
Other official capital and reserves (increase-)	-10.5	1.4	-0.4	-26.2	-38.5	-10.3	15.8	10.1

1/ Based on the Islamic (Hijri) year. See Appendix Table 13 in the report on Recent Economic Developments, to be issued shortly.

2/ Annual averages for Gregorian calendar years 1977 through 1983. The method for calculating the cost of living index has been changed on a number of occasions in recent years. The data shown are based on the splicing of the Middle Income Saudi Arabian Index and the newer All Cities Index in 1979.

3/ This item includes expenditures for "operations and maintenance" on projects, which are classified under a separate heading, beginning in 1983/84. Most of these expenditures were previously included under project expenditures.

4/ Budgetary expenditure adjusted for the net operations of specialized credit institutions and timing differences between budgetary and monetary data.

5/ Ended September 7, 1983.

6/ Equals items 1 through 4 or items 3 through 6.

7/ The following average annual exchange rates (in Saudi Arabian riyals per U.S. dollar) were used: 1977 - 3.5251; 1978 - 3.3996; 1979 - 3.3608; 1980 - 3.3267; 1981 - 3.3826; 1982 - 3.4274; and 1983 - 3.4547.

Saudi Arabia - Statistical Issues

There has been progress over the last few years in the provision of statistics to the Fund. Since Saudi Arabia began to provide the Fund with confidential quarterly reports on the geographic analysis of commercial banks' external assets during 1983, it has been among the most current reporters in the Fund's project on international banking statistics. However, in many areas, further improvement is needed, particularly in the provision of data relating to the real sector and government finance. For example, the latest month for which consumer price index data were available for inclusion in the June 1984 issue of IFS is November 1983. No government finance data have been reported for IFS or for the GFS Yearbook. It is understood that the Government has established a committee to identify incompatibilities between the Fund's GFS system and Saudi Arabian statistics. The Fund is awaiting the results of the committee's work and is ready to provide technical assistance in this area if it is required. In reporting money and banking statistics, there have been delays in the provision of SAMA's balance sheet. However, more recent data for deposit money banks are available and it is expected that the authorities will improve the currentness of these data in IFS. No balance of payments data have been reported since July 1982.

Bureau of Statistics' staff participated in computer-related technical assistance missions to SAMA in June 1981 and November 1982. Assistance was provided in the formulation of programs to develop SAMA's data base and to generate tables for the statistical bulletin. A technical assistance mission from the Middle Eastern Department visited Saudi Arabia during April-May 1984 to assist the authorities in developing statistical table formats designed to enable the authorities to monitor and analyze economic and financial developments.

The present state of coverage and currentness in IFS is summarized in the following table.

		<u>Latest Data in June 1984 IFS</u>
Real Sector	- National Accounts	1983
	- Prices	November 1983
	- Production (Petroleum)	February 1984
	- Employment	n.a.
	- Wages	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
Monetary Accounts	- Central Bank	September 1983
	- Deposit Money Banks	October 1983
	- Other Financial Institutions	1983
External Sector	- Merchandise Trade: Values-Exports	February 1984
	- Merchandise Trade: Values-Imports	Q3, 1983
	- Merchandise Trade: Prices	March 1984
	- Balance of Payments	1981
	- International Reserves	April 1984
	- Exchange Rates	April 1984