March 5, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 83/124

The following correction has been made in the final minutes of EBM/83/124 (8/29/83):

Page 24, para. 3, line 2: for "9 percent " read "90 percent"

A corrected page is attached.

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well placed to achieve its goal of maintaining stable and sustained growth. The rate of inflation was low--less than 4 percent in 1982/83; absorptive capacity had improved, largely as a result of the successful development of infrastructure during the Second Five-Year Plan; a liberal economic policy encouraging private initiative and foreign private investment had been adopted; and official external reserves were substantial despite recent adverse developments in the international oil market. He had also been encouraged by the ability of the authorities to respond quickly to changing economic conditions, as indicated by the steps taken in fiscal 1982/83 to balance the budget in the face of declining revenues. The authorities' intention to continue their policy of fiscal restraint was welcome in view of the uncertainties surrounding the world oil market. Such discipline was something that other countries might find it useful to emulate.

He welcomed the steps being taken by the Saudi Arabian authorities to diversify the economy, which seemed to be bearing fruit in a number of areas, Mr. Mtei stated. In agriculture, the country was nearing self-sufficiency in wheat production; in cement production, installed capacity was expected to meet the bulk of Saudi Arabia's requirements; in the development of petrochemicals, together with iron and steel, progress had also been made. Some success had also been achieved in the establishment of light industry. It was, however, evident that in all those areas a high proportion of financial assistance from the Government had been one of the major levers for moving the economy in the desired direction. While there was perhaps no alternative for the course that the Government had taken, at least in the initial stages, questions with regard to the efficient operation of public entities and the proper use of resources were likely to arise. In those circumstances, he had noted the advice of the staff that subsidies should not become a permanent feature of the Saudi Arabian economy. However, as transfers from the Government were an integral part of the country's social and economic strategy, it would have been helpful if the staff had discussed the implications for future growth and the allocation of resources if the present policy was to be significantly altered. For instance, the staff had reported that the price support for wheat was six times the world market price. He fully understood the authorities' preoccupation with the need for self-sufficiency in a product like wheat, but, where the comparative advantage so clearly lay with other countries, the strategy might need to be reviewed.

On the external side, Mr. Mtei commented, the staff had suggested that the exchange rate could play an important role in promoting export-oriented and import competing industries in Saudi Arabia. He did however wonder whether the manipulation of the country's exchange rate was likely to have any meaningful impact in the foreseeable future. Perhaps the staff could indicate what time frame it had in mind, and what specific areas could benefit from an active exchange rate policy. It would also be interesting to have some comments on market accessibility for any new products.

He commended the Saudi Arabian authorities for their economic assistance to other developing countries, which as a percentage of GNP had been for several years the highest among all aid donors, Mr. Mtei stated. It was noteworthy that most of the aid had been untied and had been offered in the form of general support or balance of payments assistance. Saudi Arabia also deserved commendation for the way that it was cooperating with the Fund in providing loans that had assisted the Fund in carrying out its responsibilities.

Mr. Alfidja commented that Saudi Arabia's dependence on oil--amounting to some 60 percent of GDP and 99 percent of merchandise exports--made the economy vulnerable. Yet the country had considerable potential, which, if correctly tapped, would enable it to emerge as an important industrialized economy by the end of the century. The authorities had undertaken to transform and enlarge the productive base of the economy. The success of the transformation could be gauged by the developments in the non-oil sector, principally in industry and agriculture.

Between 1977 and 1982, Mr. Alfidja went on, cement production had increased at an annual average rate of 90 percent. By 1985, Saudi Arabia was expected to be practically self-sufficient in cement. Also between 1977 and 1982, electricity and fertilizer production had increased at annual average rates of 77 percent and 12 percent, respectively. Agricultural production, while accounting for less than 4 percent of non-oil GDP, had grown at an annual average rate of about 9 percent between 1966 and 1981. The authorities were paying considerably more than world prices to producers of various foodstuffs. As a result of that policy, Saudi Arabia was expected to be almost self-sufficient in wheat by 1983/84, a remarkable achievement for a country with such a hostile environment for agricultural production. The shortage of water was the main reason why only 0.5 million hectares of cultivable land were under cultivation.

Thanks to the policy of tightening expenditure during the past three years, Mr. Alfidja observed, the decline in oil prices had not had any drastic effect on the Saudi Arabian economy. In order to offset the decline in revenue for 1982/83, the authorities had implemented fewer projects, delayed others, and limited cash advances to contractors. As a result, a small overall fiscal surplus had emerged in the 1982/83 budget. He understood that the tight expenditure policy would be maintained for 1983/84. Monetary expansion had also been moderated. Money supply, broadly defined, had risen by about 7 percent in the first five months of 1982/83, compared with 16 percent over the same period in 1981/82. The rate of increase of prices had fallen sharply in recent years as a result of the authorities' stabilization policies. Wage increases had also moderated in the second half of 1981 compared to the previous two years. It was helpful that such moderation was expected to continue.

Taking up the external sector of the Saudi Arabian economy, Mr. Alfidja noted the increasing importance of investment income from foreign assets. Together with oil earnings, such income accounted for