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GRAY/05/3152

October 6, 2005

**Statement by Mr. Solheim and Ms. Kivinen on Saudi Arabia  
(Preliminary)  
Executive Board Meeting 05/86  
October 7, 2005**

Impressive economic performance has continued in Saudi Arabia with strong growth, low inflation, large fiscal and current account surpluses and declining government debt. While this impressive performance has been supported by record oil revenues, prudent policies and increased private sector non-oil growth have also played a role. The very favorable near- and medium-term outlook provides a window of opportunity for Saudi Arabia to address the longer term challenges it faces, including further increasing private sector non-oil growth and providing employment for Saudi nationals. We broadly share the analysis and recommendations in the staff appraisal and will only briefly comment on some key issues.

We thank staff for the concise report and the relevant Selected Issues chapters and Mr. Al-Turki for the informative Buff. As previously, we encourage the authorities to consent to the publication of the papers. While the papers provide a good description of the structure of the Saudi Arabian economy, the analyses of more recent developments in some areas would benefit from better data availability. We, thus, fully support staff's call for further improvements in statistics and the recommendations to participate in the GDDS and to adopt common data standards across GCC countries in the run up to the planned GCC monetary union.

The discussion of Saudi Arabia, that takes place after the WEO discussion, seems to integrate a key message of the WEO on addressing global imbalances, i.e. that oil-producing countries should also play a role e.g. by accelerating growth-enhancing structural reforms. However, regarding the link between regional and bilateral surveillance, like Ms. Xafa, we would welcome a more regional focus in future papers. In this regard, we take note that the MCD's Regional Economic Outlook on Middle East and Central Asia was recently circulated to Directors for information. We would ask staff what is the role that is planned for the Board regarding this report and its link to today's bilateral discussion on Saudi Arabia? In this connection, we would reiterate our view on the usefulness of having a Board discussion to find the optimal approach to regional surveillance, possibly also including a standard format and timing for regional reports.

We welcome the constructive role Saudi Arabia plays in supporting oil market stability, including the plans to expand capacity. Being the world's largest oil producer and exporter,

and having the highest level of proven reserves, it is natural that the hydrocarbon sector also dominates the domestic economy. A key challenge thus remains, diversifying the economy and increasing the role of the private non-oil sector. In this regard, we welcome the recent strong growth of the private non-oil sector. Earlier structural reforms are now paying off and we agree with staff that maintaining this momentum will be crucial. Progress will need to continue in privatization, increasing openness and enhancing competition. In addition, infrastructure investments and legislative and regulatory reforms to maintain the improved investment climate will be needed so that the untapped potential, e.g. in the petrochemicals, mining and tourism sectors could be used. Moreover, as the Selected Issues paper clearly demonstrates, a key challenge will be to create sufficient employment opportunities for Saudi nationals in the private non-oil sector. This will involve strengthening education and training and pursuing a flexible Saudiization policy. We were pleased to read in Mr. Al-Turki's Buff that the new Labor Law that enhances flexibility has recently been approved.

The stance of fiscal policy has been broadly appropriate recently. Containing spending and improving its quality and reducing government debt have resulted in fiscal room to increase social and infrastructure spending. However, we regret the recent approval of public sector wage increases contrary to staff's advice. Furthermore, there is scope for improving fiscal transparency and fiscal management. In the medium- to long-term, it will be important to insulate the economy from swings in world oil prices. A more formal medium-term fiscal framework along the lines suggested by staff should be considered. Moreover, we continue to believe that it would be useful for Saudi Arabia to set up an oil stabilization fund following established best practices. We take note of the suggestion from Mr. Lynch and Mr. Campbell to consider a Norwegian-styled State Petroleum Fund.

On monetary and financial sector issues, the continuing upward trend in stock prices is a risk to the favorable outlook. We note the conclusion of the Selected Issues study that the warning signals that may point to the existence of a speculative bubble are largely explained or offset by strong economic fundamentals and specific characteristics of the Saudi economy. We also take some comfort in the authorities' view that any systemic effects on the banking system from correction of stock prices are unlikely. Nevertheless, we support staff's recommendations to manage liquidity carefully, including by introducing additional market-based monetary instruments, to further strengthen supervision and to implement the remaining FSAP recommendations.

Finally, we join staff in commending Saudi Arabia for its generous development assistance. We note from the staff paper that bilateral assistance (mainly in the form of grants and excluding debt relief) is more than 1 percent of GDP and from the Buff that Saudi Arabia's development assistance significantly exceeds the UN target. Would staff have an indication of the level for Saudi Arabia according to the standard ODA/GNI definition?