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Statement by Mr. Nimatallah on Saudi Arabia  
Executive Board Meeting  
August 9, 1982

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I would like to start by thanking the staff for the valuable set of papers they have prepared in connection with the 1982 Article IV Consultation with Saudi Arabia. My authorities are in general agreement with the staff's appraisal of the economic and financial situation in Saudi Arabia.

Oil Policies

As the staff paper has clearly indicated, Saudi Arabia's policies with respect to oil production and prices are guided by long-term international and domestic considerations. In general, these considerations are based on the following main objectives: (1) to ensure adequate supplies of oil to meet the genuine requirements of consuming countries; (2) to maintain a unified and orderly oil price system and stable conditions in the world oil market to the extent possible; and (3) to secure optimal and reasonable revenue for the Kingdom in the long run.

Saudi Arabia has consistently endeavored to maintain stability both in the price and supply of oil. My authorities have cooperated with developed and developing countries towards that objective of stabilization. Saudi Arabia believes that maintenance of stable conditions in the world oil market is imperative particularly in this period of international economic difficulties. My authorities believe that a decline in oil prices at the present time would have destabilizing effects in the medium and the long run. For one thing, the conservation efforts which were very successful in many countries over the past few years, would be thwarted if the price of oil were to decline. Furthermore, projects aimed at oil exploration as well as the development of alternative energy resources all over the world, would be threatened if not cancelled altogether. Financial institutions which have loaned billions of dollars for that purpose might experience liquidity difficulties. Some of these are already hurting and are in serious trouble as we hear today. Moreover, any decline in the price of oil could only be temporary, given the long-term supply constraints. The best way to ensure that oil prices will be stable in the future is for them to be stable now. This is the main reason why my authorities in cooperation with others have acted to prevent a decline in international oil prices at the present time.

Development Policies

Despite the substantial increase in its financial strength in the 1970s, Saudi Arabia remains, in many respects, a developing country. The economy also remains heavily dependent on the oil sector. The two major objectives of development planning in Saudi Arabia have always been to raise the level of well-being of the population and to diversify the productive base of the economy.

The first Five-Year Development Plan, which covered the first half of the 1970s, stressed building-up the basic infrastructure, especially public utilities, and improving Government services. The Second Five-Year Development Plan, covering the second half of the 1970s, emphasized the development of the physical infrastructure and the expansion of social services. The implementation of these plans has been largely successful. The actual rates of increase of non-oil GDP during the period of these two plans were higher than the Plans' targets. These rates averaged 11.6 percent during the first plan and 14.8 percent during the second plan. Furthermore, there are statistical indicators which show that the dependence of the economy on the oil sector has been reduced over time. As Appendix Table 17 of SM/82/145 shows, the contribution of the oil sector to GDP has exhibited a declining trend in real terms over the period 1975/76-1980/81. My authorities are determined to continue this trend of enhancing the contribution of the non-oil sectors to GDP.

The current third Five-Year Development Plan, covering the period 1980/81-1984/85, stresses investments in productive sectors and domestic human resource development. As in the second Plan, private sector participation in the development process is being greatly encouraged through the provision of financial and other incentives. My authorities continue to regard the objectives of the Plan as being both appropriate and attainable. As such, the expenditure targets under the Plan will not be affected by revenue considerations. Any revenue deficiencies will be compensated for by drawing on reserves, which are there fundamentally for maintaining the development pace.

#### Demand Management Policies

The Government's operations play a dominant role in the Saudi Arabian economy. The Government's direct contribution to non-oil GDP averaged about 40 percent over the past few years. Furthermore, net domestic spending of the Government has been a major factor influencing economic activity in the private sector, as well as the expansion of liquidity in the economy.

In the current budget, revenues and expenditures are balanced at SRLs 313.4 billion. Revenues are projected to decline by 15 percent and expenditures to increase by 9 percent, as compared with the provisional actual figures for the previous year. The projected decline in revenue is mainly due to lower oil revenue which is based on a lower average production and no change in the official sales price. On the expenditure side, project expenditures are budgeted at SRLs 180 billion, which represents a 25 percent increase over the provisional actuals for 1981/82. The other categories of expenditures are, however, projected to show only small changes from the provisional actuals of the previous year.

The staff has raised several fiscal issues with my authorities regarding the diversification of the revenue base, the reduction in budgetary subsidies, and medium-term fiscal planning. The staff report SM/82/131 covers the views of my authorities on these subjects, but I would like to emphasize them briefly.

With respect to diversification of budgetary revenue sources, my authorities see some merit in this approach which is in line with their stated objective of reducing the dependence of the economy on oil in the long run. However, the need at the present stage is not for raising other sources of revenue, but to develop mechanisms to raise them when it becomes appropriate to do so in the future. At this stage, my authorities are encouraging the private sector to divert most of its savings to capital formation and to hold down consumption. They are using several means to encourage capital formation, including loans on easy terms through specialized development banks and funds. When firms in the industrial, agricultural, and services sectors, have had time to establish themselves, the private sector can be taxed appropriately.

On the reduction of subsidies in the budget, a ministerial committee is currently studying the question of subsidies and its recommendations are expected to be finalized in the near future. At the present time, the maintenance of food subsidies, for example, is an important social policy objective as the Government is committed to improve the living standard and well-being of the population. However, adequate food and agricultural prices are required in every country to maintain incentives for farmers. The conflicting objectives of controlling inflation, on the one hand, and maintaining adequate prices in the agricultural sector, on the other hand, can be compromised in most cases by subsidies given to the producers of food and agricultural products. Saudi Arabia provides such subsidies, as do many countries.

As far as the other subsidies are concerned, my authorities are convinced that developing human skills for earning higher income is a good way to distribute the oil wealth. Developing skills, however, takes time, and to avoid creating a wide gap between the more fortunate and the less skilled, and because the oil wealth belongs to all the Saudis, the Government is continuing with these subsidies for the time being.

As noted earlier, there will be an overall review of subsidies when the recommendations of the ministerial committee are completed. There will be no desire to continue subsidies when they are no longer required.

With respect to the establishment of a medium-term expenditures planning process, the investment program which is embodied in the Five-Year Development Plan does represent a medium-term program. Investment expenditures will continue according to that program. However, the oil market uncertainties make it difficult to forecast reliably the behavior of oil revenue. Thus, it is extremely difficult, at this time, to plan for budgetary current expenditures on a medium-term basis.

The main determinants of the extent of monetary expansion in Saudi Arabia are the net domestic expenditures of the Government and the balance of payments deficit of the private sector. Like many other countries, Saudi Arabia has faced the problem of private capital outflows because of the high interest rates on the dollar and the other key currencies. However, the gap between domestic rates of remuneration in financial assets and international interest rates narrowed somewhat in 1981/82 as a result of some decline in international interest rates, together with a significant increase in the return on riyal-denominated assets. Private capital flows, in and out, have obviously

had an impact on credit availability for the private sector and caused fluctuations in domestic liquidity. My authorities are keen to keep monetary expansion within reasonable limits to maintain an inflation rate below 10 percent. This is a ceiling that is carefully watched.

#### External Sector Policies

Because the value of oil exports is expected to decline, and imports of goods and services are projected to increase substantially, the surplus in the 1982 current account of the balance of payments is expected to decline sharply. However, this will not affect Saudi Arabia's policy of providing generous assistance to other developing countries. Over the past six years, Saudi Arabia provided about \$28 billion in terms of official foreign aid to developing countries, which is equivalent to about 6 percent of GDP. In 1982, official foreign aid is projected at \$6 billion, which is considerably above the average of these past years.

The overall balance of payments position is projected to be in equilibrium in 1982. Saudi Arabia continues to adhere to the principle of freedom of making payments and transfers for international transactions, and imposes no restrictions on imports. My authorities will continue to manage foreign assets in a prudent and responsible fashion, not only for the interest of Saudi Arabia, but for that of the whole international community as well.

With respect to the exchange rate regime, the Saudi Arabian riyal remains, in principle, pegged to the SDR. In order to discourage speculation and to create an environment conducive to private sector confidence, my authorities also sought to preserve a fairly stable riyal-dollar exchange rate. Since late 1980, the riyal had been depreciated in a number of small increments against the dollar. However, given the sharp appreciation of the U.S. dollar against other currencies, the appreciation of the riyal against the SDR exceeded the 7.25 percent margin.

#### Output and Prices

The prudent policies, which my authorities are pursuing and which I have described above, had led to rapid economic growth in recent years, as well as to a decline in the rate of inflation. Real non-oil GDP rose by over 12 percent in both 1979/80 and 1980/81, and preliminary data indicate that it grew by about 10.5 percent in 1981/82. The growth rate in real non-oil GDP is projected at 9.5 percent in 1982/83.

At the same time, the rate of inflation has been declining steadily. The rate of increase in the implicit non-oil GDP deflator declined from 8.9 percent in 1979/80 to 7.6 percent in 1980/81 and to an estimated 5-6 percent in 1981/82. Furthermore, the two cost-of-living indices have risen by less than 2 percent during the past year. These favorable price developments were due to several factors. First, the prudent fiscal policy which limited increases in expenditures to levels consistent with the economy's absorptive capacity. Second, the removal of supply bottlenecks in the economy, especially in the area of residential construction. Third, the stability of import prices in riyal terms, reflecting a slowdown in international inflation, and the appreciation of the riyal against major currencies other than the U.S. dollar. Fourth, there continues to be no barriers to imports. Inflation is expected to remain low in 1982/83, and Saudi Arabia is expected to continue to enjoy a healthy economy.