CHAPTER 5

MACROECONOMIC ANALYSIS OF THE FOURTH PLAN

5. MACROECONOMIC ANALYSIS OF THE FOURTH PLAN

This chapter presents the quantitative framework, the fiscal and economic aggregates and their sectoral details, and discusses the related policy issues of the Fourth Development Plan.

5.1 THE ECONOMY AT THE START OF THE FOURTH PLAN

5.1.1 PERIOD OF TRANSITION

The Saudi economy throughout much of 1404/05 - 1409/1410 will best be described as being in a state of transition. The following analysis explains the nature of the main influences which will bring about this transition. The likely adjustments which the public and private sectors will make during the Fourth Plan period are also described.

5.1.2. FACTORS INFLUENCING THE PUBLIC AND PRIVATE SECTORS

In the public sector two important tendencies can be observed. The ***first*** is the virtual completion of infrastructural development. The Government's determination to finish this essential part of its long-term development strategy — even against a background of falling oil revenues — is clearly evident. After more than a decade of heavy investment in physical infrastructure and basic industries, the Government's future involvement in these areas will be substantially reduced. In accordance with this process, an increasing number of public investment projects are now entering their final phase and the volume of new work in progress is becoming correspondingly smaller.

The logical consequence of the completion of infrastructure, and the impact of lower revenues, will be a downward realignment of factor incomes (wages/salaries, profits, rents) affecting most sectors. A powerful contributor to this realignment is the ***second*** tendency in the public sector: maximizing the purchasing power of budget appropriations, both in the domestic and international markets. Measures which have already become standard government practice include: greater scrutiny of project design and implementation; broadening the basis of competition for public tenders; and the critical examination of cost levels and cost structures in tenders submitted.

The conditions currently influencing the private sector originate partly in the public sector, and partly from the private sector's own development:

— there is growing competition for the declining volume of government projects, putting pressure on margins and requiring performance to be of higher quality;

— the completion of many of the private sector's own investment projects is also making competition much stronger.

5.1.3 THE ADJUSTMENT PROCESS

Adjustments to the new situation are taking place in both the public and the private sectors. The longer-term strategy of structural change and diversification considers the producing sectors to be the main force of expansion in the economy. Therefore, in this new phase of the strategy the thrust of the Government's policy objectives will be on:

- extending financial support to private activity in the producing sectors;
- safeguarding and increasing the private sector's share in government projects;
- promoting various new partnership arrangements between the public and private sectors, relating especially to operations and maintenance projects.

Within the private sector, under-utilization of capacity or commercial space, and under-employment of the work force may well be typical of the problems facing many companies. Added to them is the narrowing of profit margins, which had previously been fairly comfortable. Such pressures will force managers to raise the level of efficiency, primarily by reducing employment-related expenditures. In many areas, highly expensive labor will be replaced or offered lower remuneration and other benefits as a condition of contract renewal.

As in other economies in periods of adjustment, it is expected that the more efficient firms will increase their market share. Considering the large number of small firms which are often loosely organized, various factors will change the size and structure of the Saudi private sector. A great deal of consolidation and rearrangement will probably take place, both in the range of activities of an individual establishment, and in the total number of establishments engaged in a particular activity. In its search for new opportunities the private sector is expected to help realize the development priorities of the Fourth Plan. This expectation is of great significance, since the diversification of the economy's structure requires the active interest and involvement of the private sector, from its acceptance, in principle, of greater participation, to its practical involvement at the level of individual products and services. The Fourth Plan is the strategic framework within which private sector initiatives, supported by government, can contribute to structural change on a hitherto unknown scale.

5.2 GOVERNMENT EXPENDITURE IN THE FOURTH PLAN

Total government expenditure in the Fourth Plan, including non-civilian items, is set at SR 1,000 billion at current prices. Despite substantial external uncertainties, the planned expenditure represents a realistic magnitude and is in line with structural changes in the economy.

This amount is nominally almost identical to the planned total budget of the Third Plan; however, compared to the lowest actual budget appropriation in the Third Plan period (SR 260 billion) the average annual expenditure in the Fourth Plan represents a reduction of between 20 and 30 percent. The corresponding reduction in respect of development agencies alone is only 13 percent, however.

5.2.1 REVENUES

Under the assumption of a balanced budget for the period as a whole, average annual revenues are estimated at SR 200 billion. Oil sales will continue to represent the principal source of revenues. The other main source of foreign currency revenues will be investment income from abroad. Domestic revenues are expected to be well in excess of SR 20 billion annually.

5.2.2 STRUCTURE OF GOVERNMENT CIVILIAN EXPENDITURES

The allocation of civilian expenditures in the Fourth Plan is shown in Table 5-1 according to the main spending categories. Almost three quarters of total civilian spending will be undertaken by the development agencies. Their expenditures will be augmented by loans from the specialized credit institutions in support of agriculture and industrial development, private housing and other socioeconomic purposes.

Other economy-related expenditures include subsidies, which will continue to be reviewed for the purposes and effects of further reductions. The recent increases in charges for gasoline and electricity, and the decrease in the wheat subsidy, are indications of likely measures to be taken. The costs of administration — that is, spending by other regulatory and administrative agencies and government offices — will be around 10 percent of total civilian spending. Provisions for foreign aid are also included in the total.

5.2.2.1 Expenditures by Development Agencies

One of the most important means by which the Government sets the direction of development is through the allocation of funds among the different development sectors. The progressively lower levels of infrastructural spending in the Second, Third and Fourth Plans (50 percent, 37 percent and 29 percent, respectively) show the way in which the structure of the economy is being shaped by changes in the composition of government expenditure.

Table 5-2 compares the envisaged composition of expenditures by development agencies in the Fourth Plan with the planned and actual expenditures in the Third Plan. The first section of the table compares the structure of expenditure in percentage terms, while the second section compares the levels of expenditure.

5.2.2.2. Classification of Development Spending

Table 5-3 presents the development expenditures of the Fourth Plan according to budget chapters, which are shown in columns, and spending categories, shown in rows. Expenditure in Chapter I is chiefly for employee compensation; in Chapter II for current government consumption; Chapter III includes allocations mainly for operation and maintenance; amounts in Chapter IV include all project expenditures.

Table 5-1

GOVERNMENT (CIVILIAN) EXPENDITURES IN THE FOURTH PLAN

(in current prices)

Category	SR Billion	Percent
1. Development Agencies		
of which:		
Economic Resources Development	130.7	
Human Resources Development	135.3	
Health and Social Development	89.7	
Transport and Communications	76.9	
Municipalities and Housing	67.4	
Sub-total	**500.0**	**72.7**
2. Transfer Payments and Reserves		
of which:		
Credit Institutions (net domestic lending)	60.1	
Subsidies and Budget Reserves	57.2	
Sub-total	**117.3**	**17.1**
3. Administration Expenses		
of which:		
Religious and Judicial	18.5	
Non-Financial Administration	7.0	
Non-Portfolio Offices	9.9	
Financial Administration	34.8	
Sub-total	**70.2**	**10.2**
Total Civilian Expenditures: (excluding the Amirates)	**687.5**	**100.0**

Table 5-2

DEVELOPMENT EXPENDITURES DURING THE FOURTH PLAN

EXPENDITURE STRUCTURE

	Third Plan		Fourth Plan
	Plan	Actual	Plan
Spending Category	(Percent)	(Percent)	(Percent)
Economic Resources Development	31.3	21.4	26.1
Human Resources Development	21.3	22.2	27.1
Health and Social Services	10.0	12.4	17.9
Transport and Communications	22.7	24.7	15.4
Municipalities and Housing	14.7	19.3	13.5
Total: Development Agencies	**100.0**	**100.0**	**100.0**

EXPENDITURE LEVEL ★

	Third Plan		Fourth Plan	
	Plan	Actual	Plan	Change from Third Plan Actual
Spending Category	SR billion			(Percent)
Economic Resources Development	190.7	120.4	130.7	+ 8.6
Human Resources Development	129.6	124.3	135.3	+ 8.8
Health and Social Services	61.2	69.6	89.7	+ 28.9
Transport and Communications	138.6	139.1	76.9	− 44.7
Municipalities and Housing	89.3	108.9	67.4	− 38.1
Total: Development Agencies	**609.4**	**562.3**	**500.0**	**− 11.1**

★ Amounts are in current prices.

Table 5-3

DEVELOPMENT SPENDING IN THE FOURTH PLAN BY BUDGET CHAPTER AND EXPENDITURE CATEGORY
(Percent)

Budget Chapter / Spending Category	I	II	III	IV	Total
Economic Resources	1.3	0.7	4.3	19.8	26.1
Human Resources	15.3	5.4	1.2	5.2	27.1
Health and Social Services	6.2	5.8	1.9	4.0	17.9
Transport and Communications	1.6	0.7	5.4	7.7	15.4
Municipalities and Housing	2.1	0.8	2.3	8.3	13.5
Total	**26.5**	**13.4**	**15.1**	**45.0**	**100.0**

The largest share of development spending is devoted to human resources, followed by economic resources, health and social services. Transport and communications, together with municipalities and housing, absorb a little over a quarter of development expenditure.

Recurrent expenditure comprises about 40 percent of the total. The share devoted to project expenditure is 45 percent and the remaining 15 percent is allocated to operation and maintenance.

Throughout the implementation of the Plan the annual budgets will be kept flexible in accordance with the uncertainties of the oil market. This flexibility will not extend, however, to priority projects or to those already being implemented. Full employment of the Saudi labor force will be another important consideration in the degree to which the budgets will be kept flexible.

5.3 GROSS DOMESTIC PRODUCT IN THE FOURTH PLAN

5.3.1 OIL AND NON-OIL SECTORS

During the years of the Fourth Plan the oil and non-oil sectors are likely to advance on courses more parallel than those followed in the Third Plan period. Accordingly, the Gross Domestic Product (in constant prices) is expected to grow at 4.0 percent per annum — about mid-way between the respective rates for the non-oil economy (2.9 percent) and the oil sector (5.6 percent).

Table 5-4

GROSS DOMESTIC PRODUCT IN THE THIRD AND FOURTH PLANS
(in constant prices of 1399/1400)

	Value Added (SR billion)			Value Change (SR billion)		Compound Rate of Change (Percent)	
	1399/ 1400	1404/ 1405	1409/ 1410	Third Plan	Fourth Plan	Third Plan	Fourth Plan
Non-oil	133.5	170.8	197.3	37.3	26.5	5.1	2.9
Oil	250.0	113.3	148.6	-136.7	35.3	-14.6	5.6
Total GDP★	**383.5**	**284.1**	**345.9**	**-99.4**	**61.8**	**-5.8**	**4.0**

★ Excludes import duties

5.3.1.1 Outlook for the Oil Sector

Saudi Arabia is the world's leading oil exporter and the third largest producer of oil. Oil revenues have, therefore, played a key role in the economy and will continue to be the most important economic factor affecting the Kingdom.

The contribution of the oil sector to GDP during the Fourth Plan is estimated to increase, on average, between 5 and 6 percent annually, mainly because of increasing exports of refined products. While a more active world economy is expected in the closing years of this decade, the estimates for crude oil output have not been moved significantly upwards and oil prices have been kept unchanged for the Plan period. Average annual exports by the oil sector are estimated to remain well below those in the first years of the Third Plan, but somewhat higher than in 1404/05.

5.3.1.2 Value Added in the Non-Oil Economy

In the classification used here, the non-oil sectors include all activities except hydrocarbon-related exploration, production, refining and other processing operations. The significance of the non-oil sectors lies not only in the expanding variety of activities they embrace, but also in their concentration (98 percent) of civilian employment. Together, the non-oil sectors represent the primary domain of activities within which the economy's structural transformation is going to take place.

Non-oil GDP in the last year of the Fourth Plan is estimated to be SR 26.5 billion greater (in constant 1399/1400 prices) than in the final year of the Third Plan. Excluding construction and related mining, (the only activities with negative growth in both the Third and the Fourth Plan periods) the envisaged growth is higher still: SR 31.5 billion. Without construction and related mining, the non-oil sectors are estimated to have averaged 7.5 percent compound growth in the Third Plan and will advance at the annual rate of 4.6 percent during the Fourth Plan period.

Table 5-5 shows that real growth in value added in the expanding sectors of the non-oil economy is practically identical in the Third and Fourth Plan periods — at least when the comparison concerns the ***level*** changes between the respective end points of the two 5-year periods. Differences nevertheless exist, especially with respect to manpower requirements, because of assumed positive trends in productivity.

5.3.1.3 GDP Contribution by Sectors

The Fourth Plan's growth estimates for the non-oil economy are based on differential growth between sectors. As indicated in Table 5-6, the growth expectations are concentrated on three sectors: agriculture, industry and finance. These sectors will have a critical role to play in the coming five years in helping to change the structure of the economy and to advance the process of diversification.

Table 5-6/a shows changes in the percentage shares of individual sectors in GDP in real terms, comparing 1409/10 with 1404/05 and 1399/1400.

Table 5-5

NON-OIL VALUE ADDED BY MAIN COMPONENT SECTORS IN THE THIRD AND FOURTH PLANS (1399/1400 prices)

	Value Added			5-Year Change ★		Average annual rate of change	
	1399/ 1400	1404/ 1405	1409/ 1410	Third Plan	Fourth Plan	Third Plan	Fourth Plan
	(SR billion)			(SR billion)		(Percent)	
Construction (incl. other mining)	44.4	41.9	36.9	− 2.5	− 5.0	− 1.2	− 2.5
Government	23.4	30.9	30.9	+ 7.5	0.0	+ 5.7	0.0
Other Sectors	65.7	98.0	129.5	+32.3	+31.5	+ 8.3	+ 5.7
Non-Oil Total	**133.5**	**170.8**	**197.3**	**+37.3**	**+26.5**	**+ 5.1**	**+ 2.9**

★ End years of Plan periods

Table 5-6

GROSS DOMESTIC PRODUCT BY ECONOMIC ACTIVITY: FOURTH PLAN (1399/1400 prices)

	VALUE ADDED 1404/05	VALUE ADDED 1409/10	Average Annual Growth
	(SR billion)	(SR billion)	(Percent)
Producing Sectors	**62,328.0**	**73,152.3**	**3.3**
Agriculture, Forestry	7,056.3	9,442.9	6.0
Other Mining and Quarrying	1,795.0	2,081.0	3.0
Other Manufacturing	12,511.4	20,612.0	10.5★★★
Petrochemicals	-----	5,149.2	------★★★
Electricity, Gas and Water	794.7	1,014.3	5.0
Construction	40,170.6	34,852.9	(-2.8)
Service Sectors	**77,552.8**	**93,239.6**	**3.8**
Trade, Restaurants and Hotels	27,069.1	30,626.2	2.5
Transport, Storage and Communications	22,177.6	28,304.9	5.0
Property	12,171.0	12,171.0	nil
Finance, Insurance, Business Services★	8,460.3	13,017.3	9.0
Community, Social and Personal Services	7,674.8	9,120.2	3.5
Government	**30,944.2**	**30,944.2**	**nil**
Sub-Total: Non-Oil Sectors	170,825.0	197,336.1	2.9
Oil Sectors	113,289.9	148,562.2	5.6
Total: GDP★★	**284,114.9**	**345,898.3**	**4.0**

★ Less imputed bank service charges

★★ Excluding import duties

★★★ The combined growth rate for both branches would be 15.5% p.a.

Table 5-6a

SECTORAL SHARES OF "NON-OIL GDP" ★
(based on constant 1399/1400 prices)

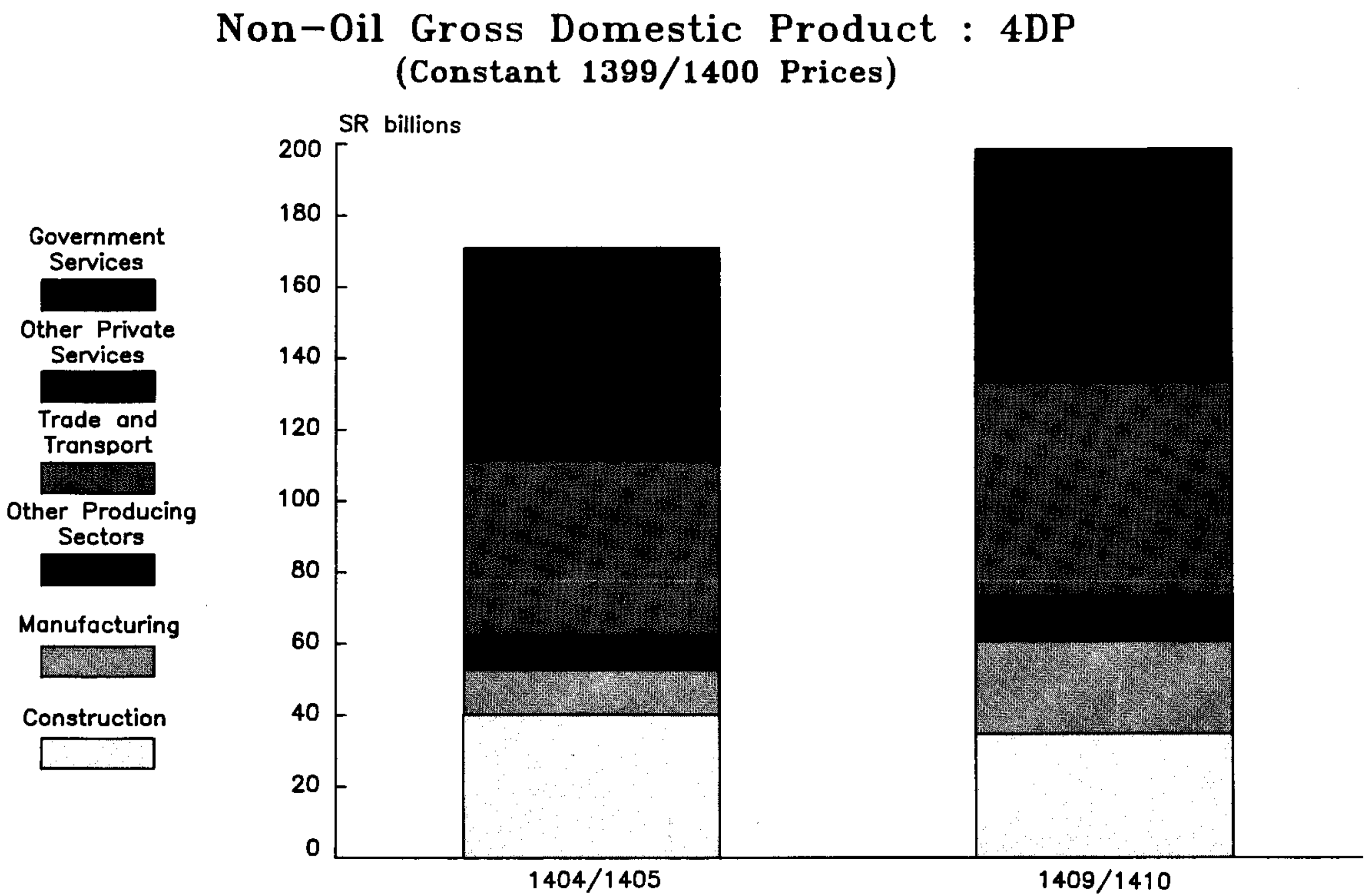
	1399/1400	1404/05	1409/10
Producing Sectors	**Percent**	**Percent**	**Percent**
Agriculture	3.5	4.1	4.8
Other Mining	1.0	1.1	1.1
Other Manufacturing	4.8	7.3	10.4
Petrochemicals	---	---	2.6
Utilities	0.2	0.5	0.5
Construction	32.3	23.5	17.7
Sub-total	**41.8**	**36.5**	**37.1**
Service Sectors			
Trade	13.4	15.8	15.5
Transport	11.8	13.0	14.3
Real Estate	8.2	7.1	6.2
Finance	3.4	5.0	6.6
Other Services	3.9	4.5	4.6
Government	17.5	18.1	15.7
Sub-total	**58.2**	**63.5**	**62.9**
Non-Oil Sectors	**100.0** (34.8)	**100.0** (60.2)	**100.0** (57.1)
Oil Sectors	(65.2)	(39.8)	(42.9)
(Gross Domestic Product)	(100.0)	(100.0)	(100.0)

★ Figures in brackets relate to Gross Domestic Product.

5.3.2 PROSPECTS FOR INDIVIDUAL SECTORS

This section examines development prospects for the individual sectors of the non-oil economy during the Fourth Plan period. In some sectors growth will stabilize at rates which can be sustained in the future, whereas in many sectors growth rates will actually decline, as a prelude to more stable future growth. Overall, the sectoral growth pattern is considerably more selective than in the past. At the same time, a return to earlier higher levels of productivity has been envisaged for practically every sector.

Figure 5-1



Non-Oil Gross Domestic Product : 4DP
(Constant 1399/1400 Prices)
SR billions
200
180
160
140
120
100
80
60
40
20
0
1404/1405
1409/1410
Government Services
Other Private Services
Trade and Transport
Other Producing Sectors
Manufacturing
Construction

5.3.2.1 Agriculture

The agricultural sector is expected to expand at an average annual rate of 6.0 percent, which is lower than the 8.7 percent rate experienced during the Third Plan. With the stabilization of wheat production, the production of other crops (such as fruits and vegetables) and livestock is expected to increase. Over two thirds of output growth is envisaged to come from productivity increases.

5.3.2.2 Mining

The mining sector will have different growth prospects in its two components: (i) the established activities, which relate to supplying construction materials, will be affected by the state of that industry; (ii) the new mining activities in the Fourth Plan period, which will intensify the exploration and evaluation phases of a variety of minerals. In some cases actual production will start.

5.3.2.3 Manufacturing

The 15.5 percent overall rate of expansion in the manufacturing sector includes petrochemicals. Excluding petrochemicals, the anticipated annual growth rate is 10.5 percent, against a comparable rate of 14 percent in the Third Plan period. It applies to two main categories: construction-related and other manufacturing, including both licensed production and small-scale non-licensed activities. With the main thrust of the Fourth Plan growth directed at new branches of production, import substitution will become important. The growth target also reflects new possibilities in agricultural processing, secondary petrochemicals, service- and maintenance-related components (especially for the basic industries), and other intermediate products. Further considerations include the scope for private joint-venture products based on technology transfer and the advantages of GCC-wide production. The manufacturing growth rate, together with those for agriculture and the financial and business services, is the central structural objective on the output side in the Fourth Plan. Its attainment will require special efforts at all levels.

5.3.2.4 Electricity, Gas and Water

The overall rate of growth is expected to stabilize at 5 percent annually, considerably below the 24 percent annual rate achieved in the Third Plan period. As before, much of the expansion is expected to take place in the fields of power generation and distribution.

5.3.2.5 Construction

Construction activity is expected to decline at an average annual rate of 2.8 percent, as against the 8.4 percent average annual decline in the last three years of the Third Plan. The envisaged remaining capacity should correspond with public and private sector demand in the coming years. However, since construction capacity is more mobile and its size cannot be approximated on the same fixed basis as that of industry, the anticipated negative growth rate is chiefly indicative of the reduction expected in the sector's labor force over the years. The decline in the number of construction workers will also be affected by expected improvements in work organization and in productivity. At the same time, stabilizing influences will also be at work as : (i) many local contractors will become involved in maintenance operations, and (ii) with the completion of big projects the structure of the industry will change to enable Saudi firms to compete for contracts.

5.3.2.6 Trade, Restaurants and Hotels

The rate of growth of this sector is expected to average about 2.5 percent annually during the Fourth Plan, substantially lower than the 8.8 percent experienced during the Third Plan. The lower growth rate will be caused by reduced levels of activity in retailing and catering, in line with a smaller expatriate labor force and the expected decline in the volume of imports. Because of intense competition, the sector will undergo substantial changes in its size structure; as a result, the level of technical and marketing standards will be upgraded.

5.3.2.7 Transport and Communications

The annual growth rate in this functionally diverse sector is expected to decrease from over 7 percent in the Third Plan to about 5 percent in the Fourth Plan.

5.3.2.8 Real Estate

This sector is likely to experience little or no growth during the Fourth Plan compared to its estimated 2 percent average annual growth during the Third Plan period. The current oversupply of rental housing and commercial buildings has resulted in high vacancy rates. As prices have been slow to decline, the potential for growth is greatly reduced, especially in view of the anticipated lower demand for real estate throughout the Plan period. However, substantial reductions in rents are expected, and the imbalance between supply and demand is likely to be reduced in later years.

5.3.2.9 Finance, Insurance and Business Services

Next to manufacturing, this will be the most rapidly growing sector in the economy. Overall, the sector is expected to grow at an average annual rate of 9 percent during the Fourth Plan. Increased activity in financial intermediary operations, expansion in data processing services, machine leasing and software, and the growth of Saudi financial services to mobilize private sector assets for domestic use, are all expected to contribute to healthy growth in this sector. Productivity increases, linked to the introduction of modern equipment and management techniques, will be the major contributing factor in this expansion.

5.3.2.10 Community, Social and Personal Services

These activities, which include domestic household services, will grow less rapidly than during the Third Plan. The envisaged decline in annual growth is from 7.8 percent to about 3.5 percent. At the same time, the growth in producers' services (chiefly repairs) is likely to gain momentum, thereby bringing the sector functionally closer to the producing sectors.

5.3.2.11 Government Services

As value added in the government sector is primarily employee compensation, the policy to limit government employment growth during the Fourth Plan means that, in constant price terms, this sector will not expand. An increase in contracting for services with the private business sector will further reduce the need for internal expansion.

5.4 MANPOWER, EMPLOYMENT AND PRODUCTIVITY

This section reviews the main issues concerning the level of employment, changes in the industrial and occupational composition of employment, characteristics of the Saudi labor force, and productivity trends in the economy.

5.4.1 ECONOMIC GROWTH AND EMPLOYMENT IN THE FOURTH PLAN

In Saudi Arabia, the relationship between economic growth and employment has been very direct and strong, with far-reaching implications for economic policy. In most other countries, the relatively slow growth in new employment opportunities is hardly keeping pace with the number of new entrants into the labor market. The growth in employment opportunities in the Kingdom has greatly exceeded the number of new Saudi entrants into the labor market. Additionally, the growth in labor productivity has remained too slow and uneven to close the gap between labor supply and requirements. As a result, economic growth in the last three Plan periods has caused substantial increases in overall, but especially in foreign, employment.

For the Fourth Plan period, employment is planned to serve the needs of structural change and to contribute to greater efficiency in all sectors of the economy. While the structural changes in the economy will require a new blend of skills, the economic growth objectives of the Fourth Plan can be achieved with an overall reduction in the labor force. The growth target for productivity in the economy as a whole during the Fourth Plan is envisaged at 4 percent per year, which implies a saving of over 855,000 work places compared to 1404/05 for the same overall output. The anticipated higher levels of output during the Fourth Plan period would, however, create some 630,000 new jobs. The net employment effect of higher productivity and increased output would therefore be 225,500 fewer jobs than in 1404/05. An equal number of foreign workers are thus expected to leave the Kingdom.

Against the overall reduction in the demand for labor, as indicated in the 225,500 fewer jobs, the entry of 374,700 Saudi new entrants into the labor market calls for a corresponding further reduction in the non-Saudi labor force. The expected total number of workers returning to their home countries over the next five years, therefore, will be at least 600,000. The detailed projections show that:

— total civilian employment is expected to decrease from 4,446,000 in 1404/05 to 4,220,500 in 1409/10 (Table 5-7);

— the share of Saudi nationals in the total labor force, which was 40.2 percent in 1404/05, is expected to increase to 51.2 percent by 1409/10;

— the share of non-Saudis in the labor force is expected to decline from 59.8 percent in 1404/1405 to 48.8 percent in 1409/1410, while their number will fall to 2,060,000 towards the end of 1409/10, from 2,660,000 in 1404/05.

Table 5-7

PROJECTED CIVILIAN EMPLOYMENT BY NATIONALITY
(1404/05 to 1409/10)

Nationality/Sex	Civilian Employment 1404/05	Civilian Employment 1409/10	Net Change	Annual Growth Rate 1404/05 to 1409/10
		(Thousand)		(Percent)
Saudi Men	1,649.2	1,984.1	334.9	3.8
Saudi Women	136.8	176.6	39.8	5.2
Subtotal: Saudis	1,786.0	2,160.7	374.7	3.9
Non-Saudis	2,660.0	2,059.8	-600.2	-5.0
Total	**4,446.0**	**4,220.5**	**-225.5**	**-1.0★**

★ the one percent annual decline in civilian employment relates to the economy as a whole. Details of employment changes by sector in the non-oil economy are given in Table 5-12.

During the Fourth Plan period, practically all new employment will be in the private sector. Employment in the public sector is expected to remain at around its current level with continued replacement of foreign staff. These essentially new conditions mean that:

— Saudis entering the labor market over the next five years will have to possess the education and skills required by the private sector. More importantly, their expectations in terms of remuneration, and their motivation and attitude towards work, will have to reflect the economic realities of the private sector.

— Materialization of all the necessary conditions for achieving the labor market objectives — especially, the creation of new job opportunities, the attainment of higher productivity, and the rapid progress with Saudiization — will depend largely on the private sector.

It is expected that market pressures and opportunities will lead to higher productivity and a consequent release of foreign labor. For its part, the Government will contribute in the following ways:

Concerning Saudis

— by giving support to Saudi new entrants to obtain or improve the necessary vocational skills;

— by specifying conditions for female employment.

Concerning non-Saudis

— by limiting new expatriate employment to the growth sectors (essentially agriculture, manufacturing, financial/business services).

In view of the full 5-year time span, the Government does not contemplate new regulations restricting the stay or employment of individual expatriates. All the new administrative measures will concern the economic sectors as such. At the same time, the Government will maintain close contact with private sector organizations in all matters relating to the scope and advances in Saudiization.

5.4.2 EMPLOYMENT BY SECTOR AND OCCUPATION

Total civilian employment (oil and non-oil sectors) details are presented in Table 5-8, together with a comparison of the percentage distribution of employment by economic activity in 1404/05 and 1409/10. While total employment increased by 1,420,000 in the Third Plan period, it will decline by 225,500 in the Fourth Plan period, thus reversing the earlier growth in the employment of foreign workers: from an average annual increase of 11.7 percent in the Third Plan to an average annual decline of 5.0 percent during the Fourth Plan.

Employment decline in the non-oil economy is the main source of the lower overall demand for labor. It will fall by a net total of 226,400 during the Fourth Plan period, or at an average annual rate of 1.1 percent. Employment in the public sector (civilian), the private services sector and the real estate sector is projected to decline slightly, while employment in the construction industry and the trade sectors will decline significantly, by 305,000 and 63,100 respectively. Employment in the manufacturing (excluding petrochemicals) and agriculture sectors is expected to increase by 119,800 and 45,600 respectively.

The occupational composition of total civilian employment in 1404/05 and 1409/10 is shown in Table 5-9. The projections show the estimated effects of structural changes in the economy on the demand for labor by occupational groups. The overall tendency will be to employ more people with higher skills. The proportion of professional, technical, administrative, and skilled workers will increase, while that of unskilled workers will decline.

Table 5-8

CHANGE IN CIVILIAN EMPLOYMENT BY SECTOR IN THE FOURTH PLAN

Economic Activity	Employment In: 1404/05	Employment In: 1409/10	Change 1404/05 — 1409/10	Distribution 1404/05	Distribution 1409/10
	(Thousand)		(Percent)	(Percent)	
Producing Sectors					
Agriculture	617.4	663.0	7.4	13.9	15.7
Other Mining	5.1	5.2	2.0	0.1	0.1
Other Manufacturing:					
- Non-petrochemicals	411.4	531.2	29.1	9.3	12.6
- Petrochemicals	---	7.0	---	---	0.1
Utilities	147.4	147.4	0.0	3.3	3.5
Construction	885.9	580.9	-34.4	19.9	13.8
Sub-total	**2,067.2**	**1,934.7**	**-6.4**	**46.5**	**45.8**
Services Sectors					
Trade	556.1	493.0	-11.4	12.5	11.7
Transport	303.4	310.7	2.4	6.8	7.4
Real Estate	12.0	10.5	-12.5	0.3	0.2
Finance	124.3	130.2	4.8	2.8	3.1
Other Services	848.8	829.1	-2.3	19.1	19.6
Government ★	469.1	446.3	-4.9	10.5	10.6
Sub-total	**2,313.7**	**2,219.8**	**-4.1**	**52.0**	**52.6**
Non-oil Sectors	4,380.9	4,154.5	-5.2	98.5	98.4
Oil sectors	65.1	66.0	1.4	1.5	1.6
Total for Economy	**4,446.0**	**4,220.5**	**-5.1**	**100.0**	**100.0**

★ Excludes non-civilian employment and includes daily wage workers, not classified as civil servants.

Figure 5 - 2

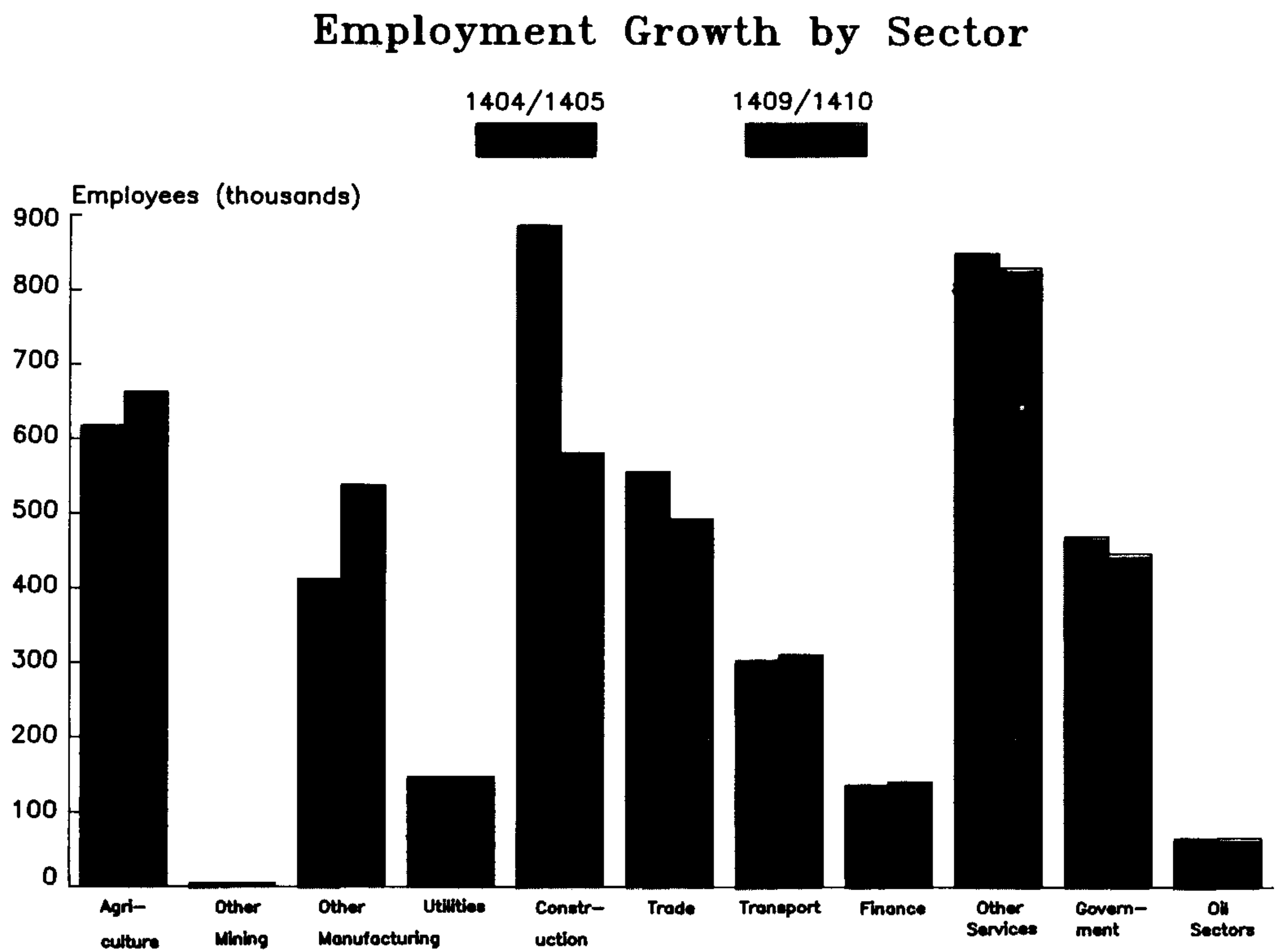

Employment Growth by Sector
1404/1405
1409/1410
Employees (thousands)
900
800
700
600
500
400
300
200
100
0
Agri-culture
Other Mining
Other Manufacturing
Utilities
Constr-uction
Trade
Transport
Finance
Other Services
Govern-ment
Oil Sectors

Table 5-9

ESTIMATED EMPLOYMENT BY OCCUPATION GROUP IN 1404/05 AND IN 1409/10

	1404/05 Employment		1409/10 Employment		Employment Change 1404/05 to 1409/10
Occupation Group	**(Thousand)**	**(Percent)**	**(Thousand)**	**(Percent)**	**(Percent)**
Professional, Technical, Administrative, and Managerial Workers	563.9	12.7	558.6	13.2	-0.9
Office Workers	1,020.2	23.0	1,001.6	23.7	-1.8
Manual Workers (Skilled/semi-skilled)	1,451.8	32.6	1,445.5	34.3	-0.4
Unskilled Workers	1,410.1	31.7	1,214.8	28.8	-13.9
Total (all civilian sectors)	**4,446.0**	**100.0**	**4,220.5**	**100.0**	**-5.1**

5.4.3 SAUDI LABOR FORCE

The total Saudi population of working age will grow at an average annual rate of 3.8 percent during the Fourth Plan period. With unchanged participation rates, the Saudi male labor force will also increase at the same annual rate. The participation rate for Saudi females is expected to increase from 5.1 percent in 1404/05 to 5.5 percent by 1409/10. In all, the number of Saudis engaged in civilian activities is expected to increase from 1,786,000 in 1404/1405 to 2,160,700 in 1409/1410 as shown in Table 5-10. The actual number of new entrants to the labor force will, however, be greater by 119,500 (totalling 494,200), because of the need to make up for losses caused by death and retirement.

Table 5-10

TOTAL SAUDI WORKING-AGE POPULATION AND CIVILIAN LABOR FORCE 1404/05 AND 1409/10

	1404/05			1409/10		
	Males	**Females**	**Total**	**Males**	**Females**	**Total**
Working-Age Population (000)	2,686.0	2,659.0	5,345.0	3,237.0	3,210.0	6,447.0
Labor Force Participation Rate (Percent)	61.4	5.1	33.4	61.3	5.5	33.5
Labor Force (000)	1,649.2	136.8	1,786.0	1,984.1	176.6	2,160.7

The successful placement into employment of these Saudi new entrants will, however, depend upon how effectively specific jobs in the private sector can be identified. The theme of "Saudiization" will have to be given practical meaning at all levels of the labor market. The Government's administrative system for monitoring the non-Saudi work force will have to be strengthened. More importantly, the Government will have to take steps to ensure the cooperation of the private sector in providing employment opportunities for Saudi workers. A parallel need is to ensure that the labor market for non-Saudi workers operates more efficiently than it has in the recent past.

From the private sector employers' point of view the attractiveness of young Saudis as potential employees depends upon how closely the skill profile of Saudi new entrants matches their skill requirements. Projections for the Fourth Plan period show that while the proportion of unskilled jobs in the economy is declining, a large number of Saudis will continue to enter the labor market looking for these types of jobs. The suitability of Saudi new entrants to the labor market becomes an issue, therefore, especially in view of the growing numbers entering the labor market with incomplete education. If Saudiization targets are to be met, and the number of non-Saudi workers reduced, emphasis on adult training must be increased.

Another unfolding problem concerns the assumption about the employment of Saudi women. Technically, in view of the increasing number of female graduates, the question is, whether, and to what extent,it is possible to increase the 'participation rate' of females in the various age groups who have finished their education. Without such an increase, the education system's direct contribution to the active work force will be lower than projected, and the progress rate of Saudiization will also be slower.

The data presented in Table 5-11 provide a broad comparison on how the additional manpower requirements — by occupation group — can be met by Saudis entering the labor market over the next five years, and from which of these occupational groups non-Saudis can be replaced.

Table 5-11

ADDITIONAL MANPOWER REQUIREMENTS BY OCCUPATION AND PROJECTED SAUDI NEW ENTRANTS TO THE LABOR FORCE BY LEVEL OF EDUCATION (1404/05 - 1409/10)

PROJECTED TOTAL JOB OPENINGS: 1404/05-1409/10		PROJECTED TOTAL SAUDI NEW ENTRANTS TO THE LABOR FORCE				REPATRIATION OF NON-SAUDI WORKERS
Occupation Group	**Total Job Openings**	**Highest Level of Educational Attainment**	**Males**	**Females**	**Total**	
	(000)		**(000)**	**(000)**	**(000)**	**(000)**
Professional, Technical, Administrative, and Managerial workers	4.3	University & College Graduates	40.7	14.1	54.8	
Sub-total	**4.3**	**Sub-total**	**40.7**	**14.1**	**54.8**	**50.5**
		Incomplete Post-secondary Education	34.4	4.6	39.0	
Office Workers	6.5	Secondary & Intermediate School Graduates	20.1	7.9	28.0	
Manual Workers (Skilled/semi-skilled)	26.3	Technical & Vocational Training Programs	100.2	1.0	101.2	
		Incomplete Secondary or Intermediate Education	87.7	12.0	99.7	
Sub-total	**32.8**	**Sub-total**	**242.4**	**25.5**	**267.9**	**235.1**
Unskilled Workers	-143.1	Elementary School Graduates and Dropouts	42.0	2.0	44.0	
		New Entrants from the Households	120.1	7.4	127.5	
Sub-total	**-143.1**	**Sub-total**	**162.1**	**9.4**	**171.5**	**314.6**
Total	**-106.0**	**Total**	**445.2**	**49.0**	**494.2**	**600.2**

5.4.4 PRODUCTIVITY

The specific objectives of manpower planning in the Kingdom have been twofold:

- to accept the underlying realities of the Kingdom's continued, albeit declining, reliance on foreign labor;
- to enhance the development and utilization of indigenous skills in the Kingdom, both through the introduction of capital-intensive techniques and by the appropriate education and training of the Saudi working population.

Accordingly, the key variables for planning have been productivity increases and improvements in the quality of the Saudi labor force. Neither of these, however, lends itself to immediate administrative action or regulation. The necessary improvements can only be achieved through carefully designed and essentially medium- to longer-term policies.

By relying on capital-intensive development the Kingdom's priorities with respect to productivity growth have always been clear. This strategy should result in reduced dependence on foreign labor, and improvements in the quality of Saudi management and the labor force.

While productivity improvements in individual sectors have been observed in the past, trends at the national level, especially in the closing years of the Third Plan, have run against expectations. The recent fall in productivity is partly explained by a lag in the private sector's response to lower rates of economic expansion.

During the Fourth Plan, the achievement of the targeted productivity improvement of 4.0 percent per annum (see Table 5-12) implies not only improved efficiency in the use of labor in the activities concerned, but also — as a precondition in many cases — a more effectively functioning labor market for Saudis and non-Saudis alike.

Table 5-12

AVERAGE ANNUAL GROWTH RATES IN EMPLOYMENT, OUTPUT AND PRODUCTIVITY BY SECTOR 1405 — 1410

(Percent per year based on 1399/1400 prices)

	Employment	Value Added	Value Added per worker
Producing Sectors			
Agriculture	1.4	6.0	4.5
Other Mining	0.4	3.0	2.6
Other Manufacturing: excluding Petrochemicals	5.2	10.5	5.0
Utilities	0.0	5.0	5.0
Construction	(-8.1)	(-2.8)	5.8
Sub-totals			
- Producing sectors, including Petrochemicals	(-1.3)	3.3	4.6
- Excluding Construction	2.8	11.6	8.6
Service Sectors			
Trade	(-2.4)	2.5	5.0
Transport	0.5	5.0	4.5
Real Estate	(-2.6)	0.0	2.7
Finance	0.9	9.0	8.0
Other Services	(-0.5)	3.5	4.0
Government ★	(-1.0)	0.0	1.0
Sub-totals			
- Services	(-0.8)	2.7	3.6
- Excluding Government	(-0.8)	3.8	4.6
Total/Average for Non-Oil Economy	**(-1.1)**	**2.9**	**4.0**

★ Excludes non-civilian employment.

5.5 STRUCTURAL CHANGE IN FOREIGN TRADE AND GDP EXPENDITURE

5.5.1 THE SIGNIFICANCE OF FOREIGN TRADE

The economy of Saudi Arabia is closely linked to the world economy:

— At the beginning of the Third Plan, exports — including services — represented in current prices 67 percent of the Gross Domestic Product (GDP). Five years later and after marked declines, the weight of exports in GDP stays at the high level of 42 percent.

— The functional significance of imports is best illustrated by their ratio (also in current prices) to non-oil GDP. In 1399/1400 the ratio's value was 99 percent, confirming a statistically well-established relationship, dating back to the early years of the Second Plan. By 1404/05, partly because of rising domestic production, the ratio had fallen to 72 percent, seemingly sharply modifying the trend in the economy's dependence on imports. Differential inflation and the rise in the purchasing power of the U.S. dollar (the oil currency) suggest, however, that in volume terms the dependence on imports changed much more slowly: the equivalent 1404/05 ratio in constant prices shows imports at 89 percent of non-oil GDP.

5.5.2 CHANGE IN THE FOURTH PLAN

In the course of the Fourth Plan changes are expected in both the exports/GDP and the imports/non-oil GDP ratios:

— The exports/GDP ratio, in current prices, is expected to decline slightly from 42 percent in 1404/05 to 40 percent by 1409/10. While the general stability of the ratio derives from projecting relatively stable levels of crude oil exports, its small decline is technical, and is due to the higher value growth in the other GDP components.

— The estimates for the Fourth Plan foresee substantial ***import substitution*** as a corollary to the growth targets for agriculture, manufacturing, and the financial/business services sectors. In current prices, the imports/non-oil GDP ratio is estimated to come down from 72 percent to 50 percent by 1409/10. In constant prices, the downward change is similarly large, from 89 percent to 67 percent.

5.5.3 IMPORT SUBSTITUTION

While the expected reduction in the functional dependence on imports is outside the Kingdom's experience, it is an indicator of the structural changes envisaged for the non-oil economy. Although precise substitution rates are difficult to predict, import substitution is implicit in almost all new production for which domestic demand has already been established. In the given technical and institutional conditions of the Kingdom, the directional emphasis of the Plan on import susbstitution ranks almost as high as the quantification of the task itself. Such goals are essential for the Fourth Plan period and beyond.

Lower oil revenues in recent years further underline the need to reduce import dependence, especially since the economy's demand for imports goes beyond traded goods and services. Throughout most of the preceding decade, the trade surplus was sufficient to cover the deficit on the other items of the "Current Account"; this may not be so in the Fourth Plan period. (While in the early years of the Fourth Plan period imbalances on the current account are possible, they will be treated as transient problems which lend themselves to a variety of technical and institutional solutions.)

5.5.4 STRUCTURAL CHANGE IN THE PATTERN OF GDP EXPENDITURE

The extent of envisaged structural change can be further illustrated numerically in the 'expenditure on GDP' tabulations. The estimates prepared for the Fourth Plan are based on these assumptions:

— As the 5-year budget for government spending is in current prices, the volume of public spending could decline in the Fourth Plan in line with the rate of imported inflation, anticipated at approximately 2.5 percent annually. A countervailing influence will be the increased international purchasing power of the currency with respect to non-dollar imports.

— Private consumption's growth rate is expected to be less than in the Third Plan period, because of the decline in the foreign labor force and the consequent fall in short-term immigrants' pre-departure purchases. Therefore, the growth rate for private consumption is estimated in a range around 3.0 percent annually, as against the 4.2 percent rate in the Third Plan period.

— Private investment is estimated to grow about 10 percent annually. Although numerically close to the Third Plan growth rate of 8.7 percent, the underlying considerations are based on important differences. The first is that the commercial sectors are unlikely to resume their previously very substantial investment activities at the beginning of the Fourth Plan period. Manufacturing and other productive sector projects will have to fill this gap. The second difference is that a higher base level for the same percentage growth rate means more private investment in the Fourth Plan in volume terms.

— ***Oil Sector*** investment is expected to increase steadily (4.4 percent annually in constant prices) over the Third Plan level, partly because major capital investment programs are to be undertaken by ARAMCO and Petromin, including a large-scale non-associated gas project in the Eastern Region, completion of refineries (such as at Rabigh), pipelines and related projects. This investment is important in strengthening the Kingdom's competitive position in the world oil market.

— The residual balancing of expenditure on GDP (see Table 5-13) includes the assumption of a decline in the volume of imports. The 3 percent annual decline in volume terms, which corresponds to the above-mentioned change in the imports/non-oil GDP ratio, will be the outcome of lower levels of private consumption and direct government investment.

A complementary assumption — technically outside, but otherwise relevant for this allocation scheme of GDP expenditure — deals with the case when imports do not fall as expected, while the volume of investment remains high. In this event, the need for additional foreign exchange — through the repatriation of private funds held abroad — will have to be considered. This course of action remains an important institutional objective of the Fourth Plan under most circumstances.

Table 5-13

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT DURING THE FOURTH PLAN (in constant 1399/1400 prices)

	1404/05	1409/10	Annual Average Growth
	(SR billion)		(Percent)
Consumption	**209.3**	**220.4**	**1.0**
Government Final Consumption Expenditure	83.6	74.7	(-2.2)
Private Final Consumption Expenditure	125.7	145.7	3.0
Gross Fixed Capital Formation	**99.5**	**118.5**	**3.6**
Government Sector	50.4	44.6	(-2.4)
Oil Sector	13.9	17.2	4.4
Private Non-Oil Sectors	35.2	56.7	10.0
Change in Stocks *	**16.5**	**(-10.0)**	**---**
Domestic Final Demand	**325.3**	**328.9**	**0.2**
Exports of Goods and Services	111.4	148.0	5.8
Less: Imports of Goods and Services	152.6	131.0	(-3.0)
Gross Domestic Product **	**284.1**	**345.9**	**4.0**

* Including statistical discrepancy.
** Excluding import duties.

5.6 START OF THE SECOND PHASE OF DIVERSIFICATION

Throughout the last decade, the Government — fully aware of the temporary nature of the favorable conditions in the oil markets — exerted maximum effort to sustain economic growth to achieve its basic development objectives. In one of the most severe recessionary periods for the world economy, the Kingdom's development programs had a unique significance, domestically as well as internationally. The effort has been successful. The Saudi economy is now in a state from which it can both:

- adjust to the less favorable demand conditions in the oil markets;
- start to implement — through selective growth — the second phase of diversification in the economy.

5.6.1 CONSOLIDATION AND STRUCTURAL CHANGE

Against the external realities and uncertainties of the international oil markets, and after the near completion of infrastructural development, the course of the economy in the Fourth Plan is one of consolidation and structural change.

Consolidation in the coming years means essentially:

- slow overall growth, in line with lower oil revenues and reductions in the foreign work force;
- concentration on efficiency in all activities, and in the use of material and human resources.

Structural change in the coming years means:

- ***in the institutional sphere*** a renewed emphasis on the dynamic role of the private sector, supported by appropriate policies;
- ***in the economy*** growth in investment, output and productivity by concentrating on the producing sectors, especially manufacturing and agriculture, as well as on the financial and business services sectors;
- ***in government activity*** the channelling of direct and indirect financial and administrative support to priority sectors and activities.

5.6.2 INTEGRATION OF OBJECTIVES

Although it has the selected sectors as its focus, the Fourth Plan is a comprehensive plan for the whole economy and for society at large. It is the result of a series of careful considerations: matching requirements with priorities, and priorities with available resources; and identifying ways in which resources can and should be used with greater efficiency. As a result, the Fourth Plan stands as a national program integrating the following specific objectives:

- the appropriate balance between economic and social development efforts;
- the new relationship between government and the private sector;
- the insistence on reducing the expatriate labor force and on increased rates of Saudiization across the economy;
- the promotion of new import-substituting activities in agriculture, industry and selected service activities;
- the emphasis on productivity improvements;
- the special support to maintenance operations as an economy-wide expanding activity.

5.6.3 NEW FRAMEWORK CONDITIONS

The Fourth Plan differs from preceding plans in the following ways:

- its output targets for the economy are based primarily on production expectations and less on programmed construction that is funded by government expenditure;
- for the critical production activities the Plan relies on the private sector which, in turn, expects favorable support conditions to prevail.

Such new framework conditions for implementation are most likely to require new policy measures in support of the Plan, as well as the review of existing ones. The effectiveness of the present regulatory system, especially its formal aspects, will be the subject of analysis and new policy formulation, as part of the implementation program of the Fourth Plan.

5.6.4 IMPORTANCE OF POLICY FORMULATION

The Fourth Plan also differs from its predecessors because it was prepared at a time when many of the complexities of the Kingdom's development had become more widely felt and their possible consequences better understood. The Plan (in its 'Key Issues' sections) evaluates achievements in many important areas from the viewpoint of potential or actual conflicts of priorities and other types of imbalances. While many of the selected issues arose within the boundaries of particular economic sectors, they are deemed to be of national, or at least inter-sectoral, significance. The Plan presents them for the purpose of remedial action for which, in a number of instances, policy options are outlined.

The importance of policy formulation, and of institutional aspects in general, is one of the Fourth Plan's most distinctive features. It also shows that, as in the structure of the economy, so too in the institutional framework, new priorities will assert themselves and will govern action.

It will be the task of the relevant government agencies to ensure that the framework is comprehensive, functionally up-to-date and provides the economy's various participants with the proper scope for expansion in both their domestic and international transactions. A new feature of the Fourth Plan is the inclusion of Plans for all the individual Amirates in the Kingdom, based on intensive visits carried out by working groups over a period of twelve months.