CHAPTER 5

THE NATIONAL ECONOMY IN THE FIFTH DEVELOPMENT PLAN

5. THE NATIONAL ECONOMY IN THE FIFTH DEVELOPMENT PLAN

5.1 THE ECONOMY AT THE START OF THE FIFTH PLAN

The Fourth Development Plan marked a period of transition in the development of the Saudi economy. Two major factors were expected to affect the economy's adjustment process during the Plan period:

- the virtual completion of the government's infrastructure investment program, leading to lower requirements for government expenditures and a general downward realignment of factor incomes (wages, profits and rents);

- the efforts to maximize the purchasing power of budget appropriations, generating greater competition for government contracts in the private sector, and thus enhancing cost efficiency on public sector projects.

The unexpectedly severe decline in oil revenues greatly reinforced these tendencies and led to a reversal of the long established growth trend in the non-oil economy. Under these adverse revenue conditions, the government recognized that a period of large budget deficits would be necessary to ensure the continued provision of high quality services to citizens. Accordingly, government recurrent expenditures were stabilized at relatively high levels. Government investment expenditures, on the other hand, declined more rapidly than planned, and, as a result, the emerging private corporate sector -- whose activities had been closely connected to public sector investment -- was confronted with major adjustment problems. Falling profit margins and lower capacity utilization, although anticipated in the Plan, put even greater downward pressure on future investment plans than expected.

Notwithstanding the economic difficulties arising from the decline in oil revenues and the negative growth rates in the early years, the non-oil economy has successfully stabilized and has shown signs of economic recovery and renewed growth in the later years of the Fourth Plan. In this regard, the Kingdom's development strategy based on economic diversification and structural change has proved more resilient against external pressures than has been the case with other developing countries. However, this resilience can be attributed more to new economic policy measures and stable recurrent expenditure of the government, together with the availability of foreign exchange reserves, than to any significant lessening in the Kingdom's vulnerability to the fluctuating oil market.

The Fifth Development Plan is an important transitional phase for the Kingdom, as it seeks to build on the recovery that was evident towards the end of the Fourth Plan. With the completion of much of the infrastructure investment program, the physical foundation of a modern economy will have been established. In addition, the provision of basic social services, particularly education and healthcare, have been extended throughout the country. The Saudi economy has now entered a new stage in its development, which is characterized by a very different environment from that prevailing in earlier Plans. The new era is marked by two critical factors:

- oil revenues that are expected to grow to more moderate levels compared to the high levels experienced in the past;

- the need to expand private economic activity and to lessen its dependence on government expenditure.

With the passing of the infrastructure stage of development, the creation of new output capacities will become increasingly dependent on private sector expectations and actions. The government's responsibility in the Fifth Plan will be to create a climate which is conducive to the expansion of private investment, through a combination of regulatory measures, financial and other incentives, including the joint public/private financing of development projects.

In the Kingdom's case, diversification has usually meant the progressive reduction of the domestic economy's dependence on crude oil as its almost exclusive source of exports, budget revenues and sectoral value added. It included the more immediate objective of raising the contribution of non-oil GDP in the economy. At the same time, in terms of the balance of payments, reducing structural dependence on oil revenues was seen as a long term objective to be reached through selective sectoral development, such as petrochemicals exports, growth in agricultural output, and generally through the expansion of new foreign exchange earning/saving activities. Under the new oil market conditions facing the Kingdom, however, with limited potential for higher revenues, this perspective will have to change. While resumption of overall economic growth will be an important policy objective of the Fifth Plan, the balance of payments consideration will be accorded an equally high priority in evaluating the contribution of new activities and investments.

Despite all these difficulties, the Saudi economy has entered the Fifth Plan period with many strengths and advantages. Living standards are high, business prospects and optimism are strengthening and a large, high quality, social and physical infrastructure system is in place.

5.2 MACROECONOMIC OBJECTIVES

The macroeconomic framework for the Fifth Development Plan has been formulated in accordance with the objectives and strategic principles of the Plan, taking into account the economic conditions prevailing at the time of the Plan's preparation. Accordingly, the strategy for the Fifth Plan gives priority to resumption of steady economic growth, improving the balance of payments position, continuing to promote structural change to achieve diversification, and strengthening of the private sector. In line with these objectives, the Plan strategy incorporates a renewed emphasis on investment, together with appropriate incentives for the private sector to increase its contribution to the process of diversification and structural change. It calls for further reductions in the budget and the current account deficits. The Plan envisages a moderate but steady increase in total public expenditures, together with measures to further increase efficiency in the government sector, and to increase non-oil revenues. Further increases in non-oil exports and reductions in imports through efficient import substitution are also high priority targets. The challenge for the Fifth Plan is to build on the recovery that began in the last years of the Fourth Plan, and set the economy back on the course of long term growth and development that has extended since the First Plan.

The cornerstone of economic growth in the Fifth Plan is investment, which in earlier periods was initiated predominantly by the government sector. However, with the completion of the majority of the infrastructure, investments will be increasingly needed for activities which are within the domain of the private sector. As the importance of the private sector in the economy grows in the Fifth Plan years and beyond, the government's function of guiding future development will increasingly have to be exercised indirectly, through a comprehensive policy framework which encourages investment in activities which are in accordance with the Kingdom's long term development objectives. The policy-focused strategy of the Fifth Plan will employ a much broader array of economic policy measures than in previous plans. These policies will be directed toward the following objectives:

- **Stabilization of the Economy** through stable government expenditure and avoiding sharp increases and decreases in the budget. Thus, government expenditure will continue to increase at a modest rate, thereby enabling the private sector to base its forecasts and set its policies accordingly.

- **Broaden the Revenue Base of the Government** by increasing non-oil revenue sources in order to reduce the budget deficit and to lessen the impact of volatile world oil markets on the government budget.

- **Expand and Diversify the Economy** through the continuous implementation of new initiatives to support private sector activities and increase its contribution to the national economy, particularly in the producing sectors.

- **Increase Investment :** The plan envisages a steady recovery in government investment expenditure, while a high level of private sector investment will also be stimulated through a broad range of government initiatives.

- **Strengthen the Competitiveness of Saudi Industry** through measures that will enable Saudi producers to effectively compete with imported goods in the domestic market and to increase and broaden their penetration of export markets. Policies to increase productivity, such as improving the skill levels of the labor force and introducing more advanced technologies, are a high priority in the Fifth Plan.

- **Improve the Balance of Payments** by encouraging rapid growth in non-oil exports and through import substitution. The maintenance of official foreign exchange reserves and the repatriation of assets held abroad by the private sector will have high priority.

5.3 MACROECONOMIC DEVELOPMENTS (GDP)

An essential element of the planning process is to establish targets for the key elements of the economy. These targets present a comprehensive and consistent picture of the desired structure of the economy, reflecting production expectations and the Kingdom's overall development objectives for the Fifth Plan period. The Plan also identifies appropriate policies for achieving these targets and emphasizing the priority given to continued structural change and economic diversification.

Growth Targets

The targeted real growth rate for Gross Domestic Product (GDP) during the Fifth Plan is 3.2 percent per year (see Table 5.1 and Figure 5.1). The non-oil sectors are targeted to grow faster than the overall economy, at an average annual rate of 3.6 percent. The significance of these sectors lies not only in their contribution to economic diversification, but also in their dominant role in civilian employment. Accordingly, their Fifth Plan targeted growth rates are higher than those set for the Fourth Plan, reflecting the economic recovery achieved by the end of the Fourth Plan. This renewed economic growth will result from the implementation of a broad range of financial, regulatory and institutional measures and the anticipated responses from the private sector. These will include:

- a renewed emphasis on investment expenditure in the state budget;

- supporting the growth of private sector investment, both for new activities and for enhancing productivity;

- mobilization of the private sector's financial assets and the development of a domestic capital market;

- more effective utilization of the workforce.

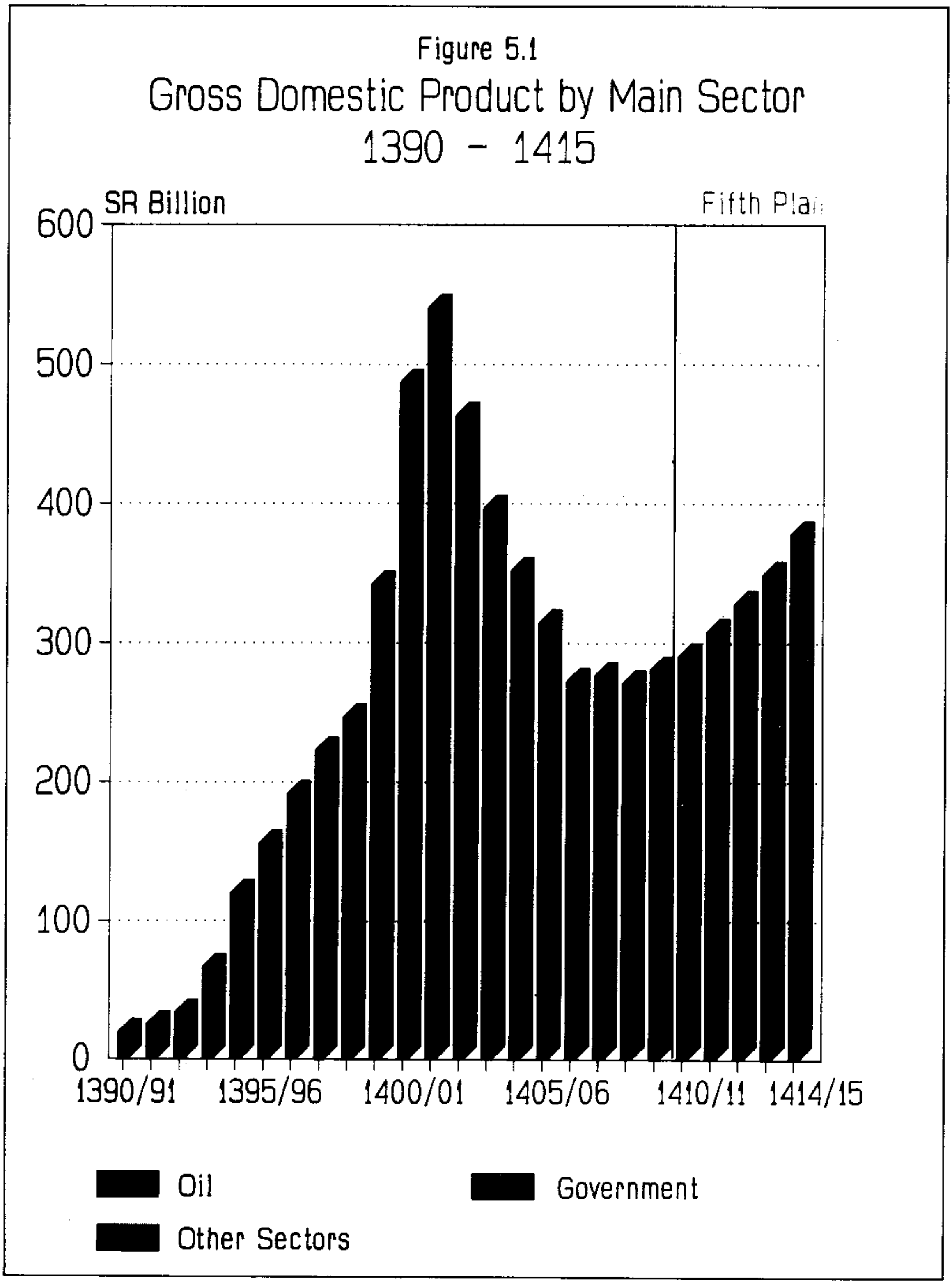


Figure 5.1
Gross Domestic Product by Main Sector
1390 - 1415
SR Billion
Fifth Plai
600
500
400
300
200
100
0
1390/91
1395/96
1400/01
1405/06
1410/11
1414/15
Oil
Government
Other Sectors

TABLE 5.1

Gross Domestic Product in the Fifth Plan
(in constant 1404/05 prices)

	Value Added (SR billion) 1409/10	1414/15	Average Annual Growth (Percent)
Non-Oil Sectors	**209.1**	**249.3**	**3.6**
Government Services	56.2	58.4	0.8
Other Non-Oil Sectors	152.9	190.9	4.5
Oil Sector *	140.2	159.9	2.7
Gross Domestic Product **	349.3	409.2	3.2

* In this table, the 'oil sector' is defined according to the conventional definition used by the CDS and includes petroleum refining. Because of its linkages with other economic sectors, petroleum refining is included as part of the non-oil producing sectors in all other tables.

** Including imputed bank service charges less import duties.

5.3.1 Sectoral Developments

The continuation and acceleration of structural change is a key objective in the Fifth Plan. This adjustment process will be facilitated by the improved competitiveness of Saudi products as a result of declining costs of production in the Kingdom in recent years, through both productivity improvements and falling labor costs. Therefore, a considerable boost to the producing sectors is expected in the Fifth Plan period through continued import substitution and the pursuit of export opportunities. Resumption of positive growth in the overall economy and expanding real incomes will also increase demand for goods and services. Though all sectors are expected to grow, agriculture, petrochemicals, other manufacturing, and financial, insurance and business services are expected to be the leading growth sectors in the Fifth Plan (see Table 5.2).

Agriculture

Agricultural production expanded rapidly during the Fourth Plan period in response to strong government support. Real growth over the Fifth Plan period is expected to average a vigorous 7 percent per year, reflecting the strong infrastructural base which has been established and the considerable agricultural potential of the Kingdom. Government support to the sector will encourage a gradual shift in the structure of production, away from crops which require excessive inputs of scarce water resources toward more high value-added products.

Mining

The mining sector is expected to resume growth in the Fifth Plan as a result of the expected increased demand for construction materials, as well as from development of the Kingdom's precious metals and other non-oil mineral resources.

TABLE 5.2

Gross Domestic Product by Sector in the Fifth Plan (in constant 1404/05 prices)

	Value Added (SR billion)		Average Annual Growth (Percent)
	1409/10	1414/15	
Producing Sectors	**88.0**	**115.9**	**5.6**
Agriculture	22.2	31.1	7.0
Other Mining	1.7	2.1	4.0
Manufacturing	**33.1**	**45.4**	**6.5**
Petroleum Refining	17.9	23.3	5.4
Petrochemicals	4.9	7.3	8.0
Other Manufacturing	10.3	14.8	7.5
Public Utilities *	(0.8)	(1.1)	6.9
Construction	31.8	38.4	3.8
Service Sectors	**82.8**	**98.3**	**3.5**
Trade	28.2	32.7	3.0
Transport, Communications	21.7	25.3	3.2
Real Estate	9.4	10.8	2.8
Financial and Business Services	13.6	18.7	6.6
Community and Personal Services	9.9	10.8	1.7
Government Services	56.2	58.4	0.8
Crude Oil and Natural Gas	122.3	136.6	2.2
Gross Domestic Product	349.3	409.2	3.2

* Value added in 1404/05 prices is negative due to operating revenues not covering costs for material inputs in the base year.

Oil Refining

The petroleum refining sector will be further developed during the Fifth Plan period in line with the Kingdom's industrialization strategy of increasing the domestic value added from its crude oil resources. The sector is expected to grow by 5.4 percent per year on average, as existing refineries are upgraded and capacities increased through completion and operation of the Rabigh refinery.

Petrochemicals

Rapid expansion of production capacity, together with successful penetration of foreign export markets, resulted in real growth rates for the petrochemicals sector exceeding 50 percent annually during the Fourth Plan. Saudi Arabia is today a major supplier to world markets for many important petrochemical products. The sector entered the Fifth Plan operating at full capacity. Some expansion of capacity is expected in the early part of the Plan, but capacity constraints and world market conditions will slow output growth to around 8 percent per year during the next five years.

Other Manufacturing

The long term process of industrialization is the prime mechanism through which the Saudi economy will undergo structural change and diversification. In this regard, the 'other manufacturing' sector has an important role to play. Up till the Fourth Plan, the linkages generated by high levels of construction activity established the production of building materials as the biggest single category of manufacturing. Thus, the construction downturn of the Fourth Plan years negatively affected overall manufacturing output. Its revival during the Fifth Plan period will, therefore, positively influence growth prospects in this sector. Therefore, a considerable boost to the manufacturing sector is expected in the Fifth Plan period through continued import substitution and the pursuit of export opportunities. Resumption of positive growth in the overall economy and expanding real incomes will also increase demand for manufactured goods. In addition, the rapid development of agriculture and petrochemicals in recent years has created major new opportunities in the food processing and secondary/tertiary petrochemicals industries. The Peace Shield and Al-Yamamah Offset Programs will also stimulate activity in some high technology manufacturing industries. As one of the leading growth sectors in the Fifth Plan, outside of petrochemicals, 'other manufacturing' is expected to grow at an average annual rate of 7.5 percent.

Public Utilities

The electricity, gas and water sector has grown at high rates in the past, reflecting rapid growth of energy intensive production methods, new consumption patterns, and subsidized user tariffs. Adjustments in user tariffs and measures to improve efficiency have significantly improved the financial situation of these utilities in recent years. Average annual growth in the sector is expected to be 6.9 percent during the Fifth Plan.

Construction

Construction sector output declined by more than one-third in the Fourth Plan years as a result of the completion of major infrastructure projects. Competition between contractors in the declining market has led to a substantial reduction in profit margins. Capacity in the sector has been broadly realigned with demand through the departure of a number of major foreign construction companies from the Kingdom. Several Saudi-owned companies have now taken their place. The increase in aggregate investment expenditures targeted in the Fifth Plan will stimulate construction activity. Overall, the sector is expected to expand by 3.8 percent annually during the Fifth Plan, which will be a major recovery from the shrinkage that took place during the previous five year period.

Trade

Growth in the trade, restaurants and hotels sector is expected to average 3.0 percent per year during the Fifth Plan, following a small decline during the Fourth Plan years. The expected recovery will be driven by increased consumer spending for retail goods, food services, recreation and increased domestic tourism, and a revival in general business activity.

Transport and Communications

The transport and communications sector is targeted to grow by 3.2 percent annually in the Fifth Plan as a result of the generally higher level of economic activity and expected stronger demand for communications services.

Real Estate

The rapid increase in the number of rental units and commercial building space resulted in substantial excess capacity and falling rents in the real estate sector throughout the Fourth Plan. Population increases and growth in personal incomes, together with growing demand for commercial and office rental space, is expected to lead to a gradual recovery of the sector.

Financial and Business Services

The finance, insurance, and business services sector staged a recovery in the last year of the Fourth Plan, after experiencing earlier difficulties due to the general decline in the economy. Compared to other countries at the same or a more advanced stage of development, the sector is not yet fully developed in the Kingdom. Modern knowledge- and information-based financial and business services are a prerequisite for sustaining industrial and economic development. Therefore, success in meeting the Fifth Plan targets for rapid growth in the producing sectors depends on the availability of supporting financial and other business services. As industrialization and economic diversification accelerate and financial markets become more developed, the demand for these services is expected to expand rapidly. This, together with measures focusing on institutional redirection, are expected to result in strong real growth of 6.6 percent per year in this sector.

Community and Personal Services

The community and personal services sector is relatively small in terms of value added, but important from an employment point of view. The dominant part of the sector is domestic household services. Because of a shift in the nationality composition of employees, relative costs for these services have fallen in recent years, thus stimulating demand. This trend is likely to slow down during the Fifth Plan as wage levels stabilize.

Government Services

Value added in the government sector is primarily employee compensation. The limited expansion of public sector employment targeted for the Fifth Plan, therefore, will be reflected in a low growth rate for the government sector's contribution to GDP.

Crude Oil

The crude oil and natural gas sector is expected to grow at an average annual rate of 2.2 percent.

5.3.2 The Structure of the Economy

The targeted growth rates for the individual sectors will gradually affect the structure of the economy (see Table 5.3). The government's share of non-oil GDP is expected to fall significantly during the course of the Fifth Plan. The share of the producing sectors within non-oil GDP is expected to increase from about 38 percent in 1409/10 to over 43 percent in 1414/15. The sectors mainly contributing to this growth include agriculture, petrochemicals and other manufacturing. Overall, the share of the service sectors in non-oil GDP is expected to change only modestly. The crude oil sector is expected to account for about one-fifth of the total economy during the Fifth Plan, considerably lower than its share at the beginning of the Fourth Plan, when it exceeded one-third of total GDP.

TABLE 5.3

Structure of the Economy
(in current prices)

	Value Added (SR billion)		Shares of Non-Oil Gross Domestic Product (Percent)		
	1409/10	1414/15	1404/05	1409/10	1414/15
Producing Sectors	**84.6**	**126.3**	**36.8**	**38.5**	**43.3**
Agriculture	22.8	34.8	5.0	10.4	11.9
Other Mining	1.8	2.4	0.8	0.8	0.8
Manufacturing	**25.0**	**41.4**	**11.9**	**11.4**	**14.2**
Petroleum Refining	9.9	16.5	6.0	4.5	5.7
Petrochemicals	5.7	9.9	0.2	2.6	3.4
Other Manufacturing	9.4	15.0	5.7	4.3	5.1
Public Utilities	0.8	1.1	(0.3)	0.4	0.4
Construction	34.2	46.6	19.4	15.5	16.0
Service Sectors	**78.6**	**102.9**	**40.7**	**35.7**	**35.2**
Trade	27.4	33.4	13.1	12.5	11.4
Transport, Communications	21.4	27.6	10.3	9.7	9.5
Real Estate	6.1	9.0	5.6	2.8	3.0
Financial and Business Services	13.7	20.9	7.5	6.2	7.2
Community and Personal Services	10.0	12.0	4.2	4.5	4.1
Government Services	56.8	62.6	22.5	25.8	21.5
Sub-Total: Non-Oil Sectors	220.0	291.8	100.0	100.0	100.0
Crude Oil and Natural Gas	60.2	87.1	—	—	—
Crude Oil and Natural Gas as Share of GDP (percent)	—	—	34.2	21.5	23.0
Gross Domestic Product	280.2	378.9	—	—	—

5.3.3 Structure of Expenditure on Gross Domestic Product

The priority given to stable economic growth and long term capacity expansion is reflected in a high growth rate for capital formation. Domestic final demand is expected to increase at a lower rate than GDP, reflecting the increase in net exports necessary to achieve the targeted improvement in the current account balance. Total consumption will, therefore, increase at a lower rate than GDP.

The highlights of the expected changes in the major components of expenditure on GDP over the Fifth Plan period (see Tables 5.4 and 5.5) are summarized below:

- Total consumption expenditure is expected to grow at an average annual rate of 2.7 percent, thus reversing its average annual decline of 3.5 percent during the Fourth Plan period, with private consumption growing twice as fast as government consumption, as a result of higher private incomes, and rationalization of consumption expenditures and improved efficiency in the government sector.

- Investment is estimated to grow at an average annual rate of 7.0 percent, reflecting the Fifth Plan's renewed emphasis on investment, with both private and public sectors reversing the downward trend of the Fourth Plan years. The source of this new investment will be a significant shift in government expenditure from recurrent to project expenditure, while private investment is expected to respond positively to a range of new institutional measures and restructured economic incentives. As a proportion of GDP, (which amounted to SR 280.2 billion in 1409/10), investment expenditure is expected to increase from 20.7 percent in 1409/10 to around 23 percent in 1414/15, when GDP is expected to reach SR 378.9 billion.

TABLE 5.4

Expenditure on Gross Domestic Product
(in constant 1404/05 prices)

	SR billion 1409/10	SR billion 1414/15	Average Annual Growth (Percent)
Consumption	**234.1**	**267.2**	**2.7**
Government	94.7	101.8	1.5
Private	139.4	165.4	3.5
Gross Fixed Capital Formation	**55.5**	**78.1**	**7.0**
Oil Sector	7.0	8.2	3.2
Government Sector	19.9	30.2	8.6
Private Non-Oil Sectors	28.6	39.7	6.8
Change in Stocks *	**(2.5)**	**(16.3)**	—
Domestic Final Demand	**287.1**	**329.0**	**2.8**
Net Exports	**62.2**	**80.2**	—
Exports	162.3	197.5	4.0
Less Imports	100.1	117.3	3.2
Gross Domestic Product	**349.3**	**409.2**	**3.2**

* Including statistical discrepancy.

TABLE 5.5

Structure of Final Demand
(in current prices)

	SR billion		Shares in Gross Domestic Product (Percent)		
	1409/10	1414/15	1404/05	1409/10	1414/15
Consumption	**231.4**	**286.2**	**79.7**	**82.6**	**75.5**
Government	95.2	109.9	34.4	34.0	29.0
Private	136.2	176.3	45.3	48.6	46.5
Gross Fixed Capital Formation	**58.0**	**88.4**	**27.4**	**20.7**	**23.4**
Oil Sector	7.3	9.1	2.7	2.6	2.4
Government Sector	20.8	33.6	13.2	7.4	8.9
Private Non-Oil Sectors	29.9	45.7	11.5	10.7	12.1
Change in Stocks *	**3.4**	**(2.8)**	**5.7**	**1.2**	**(0.8)**
Domestic Final Demand	**292.8**	**371.8**	**112.8**	**104.5**	**98.1**
Net Exports	**(12.6)**	**7.1**	**(12.8)**	**(4.5)**	**1.9**
Exports	108.6	162.2	41.3	38.8	42.8
Less Imports	121.2	155.1	54.1	43.3	40.9
Gross Domestic Product	**280.2**	**378.9**	**100.0**	**100.0**	**100.0**

* Including statistical discrepancy.

5.4 GOVERNMENT EXPENDITURE IN THE FIFTH PLAN

The public expenditure program for the Fifth Plan aims at achieving economic recovery and stabilization, leading to steady growth in the economy. Recognizing the expected limitations on revenues during the Plan period, priority has been given to creating appropriate conditions to achieve planned economic growth through:

- a moderate increase in total government expenditures;

- institutional measures and policies for the optimal utilization of budget resources, the development of the financial market and support for the private sector.

Total government expenditure in the Fifth Plan, including non-civilian items, is set at SR 753 billion in current prices, which is 9.1 percent less than the actual expenditures over the Fourth Plan period (see Figure 5.2). However, compared to the budget allocation for the last year of the Fourth Plan (1409/10), the average annual expenditure of the Fifth Plan represents an increase of about 7 percent.

Although an important element of the Fifth Plan's overall development strategy is the relative decline in the weight of direct government expenditure in the economy, particularly recurrent expenditure, total public sector investment will be higher in the Fifth Plan than its actual level in the Fourth Plan. This positive development will be achieved by making increasing use of non-budget investment financing by the public corporate sector, as well as shifting the structure of government expenditure away from recurrent expenditures in favor of project expenditures. In addition, the lending activities of the government's specialized credit institutions, unlike in the past, will no longer be financed from the budget, but rather exclusively through the repayments of past loans. The Fifth Plan allocations also take into account the possibility of joint public/private financing of development projects.

5.4.1 Structure of Government Civilian Expenditure

The government civilian expenditures in the Fifth Plan are set at SR 498 billion, representing two-thirds of total government expenditure. They include: expenditures of the development agencies, subsidies, administration costs for the regulatory/administrative agencies and government offices, (some of which provide social services, but are not part of the development agencies), and foreign aid (see Table 5.6). About 72 percent of total civilian spending will be undertaken by the development agencies. Some development projects will be financed directly by the private sector in coordination with the development agencies and the Ministry of Finance and National Economy.

Figure 5.2

Government Expenditure
1390 - 1415

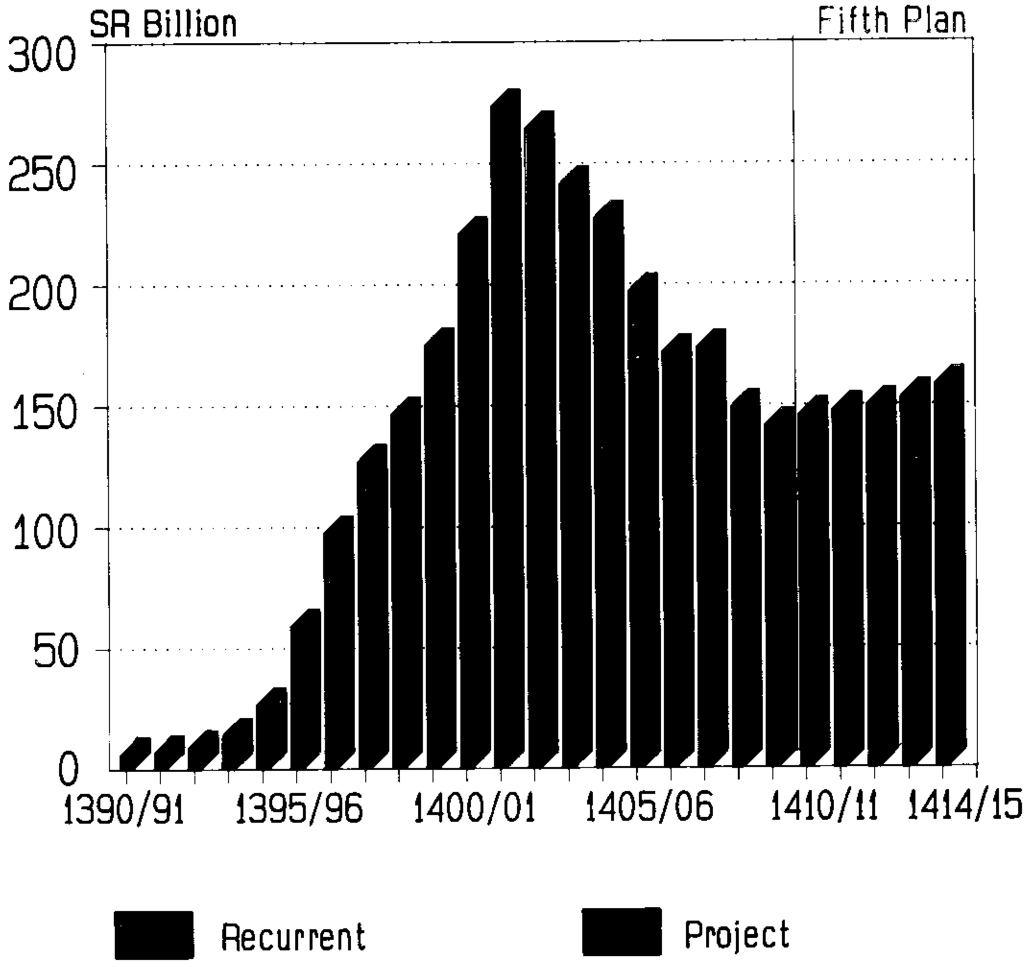


TABLE 5.6

Government (Civilian) Expenditure in the Fifth Plan
(in current prices)

	SR billion	Percent
Development Agencies		
Economic Resources	56.5	
Human Resources	139.9	
Health and Social Services	63.9	
Transport and Communications	52.6	
Municipalities and Housing	44.8	
Sub-total	357.7	71.9
Other Government Agencies		
Religious and Judicial	13.4	
Other Agencies	17.7	
Sub-total	31.1	6.3
Other Expenditures		
General Items	88.4	
Subsidies	20.4	
Sub-total	108.8	21.8
Total Civilian Expenditure	**497.6**	**100.0**

5.4.2 Expenditures of the Development Agencies

The Fifth Plan expenditure programs of the development agencies combine a moderate increase in overall expenditures with measures to ensure greater efficiency in the use of available funds. More emphasis is placed on financing development projects, while maintaining recurrent expenditures to fund the provision of public services. Project expenditures of the development agencies will be increased, so that high priority projects aimed at economic restructuring and supporting private sector expansion can be undertaken, as well as projects essential for the well-being of the population. The total expenditures of development agencies are targeted to increase at an average annual rate of 5.8 percent (see Table 5.7). Within total expenditure, projects will be the fastest growing expenditure category, expanding at an average annual rate of 11.6 percent. When funding provided by the specialized credit institutions is included, through repayments of past loans, the overall development expenditure allocations in the Fifth Plan are 15.6 percent higher than their actual level during the Fourth Plan period.

TABLE 5.7

Development Expenditure by Budget Chapter
(in current prices)

Budget Chapter		Expenditures (SR billion)	Share of Total (Percent)	Average Annual Growth (Percent)
I and II	Salaries and Supplies	195.8	54.7	3.6
III	Operations and Maintenance	53.3	14.9	4.9
IV	Projects	108.6	30.4	11.6
	Total	**357.7**	**100.0**	**5.8**

The distribution of development expenditures by budget chapter and expenditure category is summarized in Table 5.8. Chapter I (mainly employee compensation) and chapter II (government current consumption) expenditures are lower than in recent budgets, because of the higher priority given to both project and operation and maintenance expenditure in the Fifth Plan. Together, these two chapters will account for around 55 percent of total spending by the development agencies. Salaries will continue to absorb the largest share, but will increase at a modest rate. This reflects the expectation that the private sector will absorb a growing percentage of the Saudi labor force, and the importance given to restoring fiscal balance between recurrent and project expenditure, and improving efficiency in the government sector.

Expenditures on operations and maintenance (chapter III), which are primarily directed towards sustaining the value of the Kingdom's infrastructure and equipment, will account for 15 percent of total spending of the development agencies, while project spending (chapter IV) will account for over 30 percent. When the investment component of the operations and maintenance expenditures are taken into account, total investment expenditures by the development agencies will substantially exceed the project expenditure allocation.

The largest share of recurrent expenditures is allocated to human resource development, and health and social development, both of which have high manpower requirements. For major government services such as education and health, recurrent expenditures will increase to accommodate population growth in the age brackets requiring these services. However, the measures envisaged in the Plan to further improve efficiency in the public sector will enable these expenditures to increase at a lower rate than demand for these services, while maintaining present service availability and quality.

TABLE 5.8

Development Expenditure by Budget Chapter and Spending Category (Percent)

Spending Category	Budget Chapter I and II	III	IV	Total
Economic Resources	2.6	3.5	9.6	15.7
Human Resources	32.9	0.6	5.7	39.2
Health and Social Services	13.0	2.8	2.1	17.9
Transport and Communications	2.7	5.6	6.4	14.7
Municipalities and Housing	3.5	2.4	6.6	12.5
Total	54.7	14.9	30.4	100.0

The structure of expenditure on development projects in the Fifth Plan emphasizes the completion of major infrastructure programs and the priority given to different sectors of the economy (see Table 5.9).

Economic Resources

Only part of the total public sector investment on economic resources will be financed from the government budget. Given the success in establishing financially solid economic institutions that are increasingly capable of generating their own investment funds, it is normal to expect budget allocations for the development of economic resources to decline over time. Thus, major investments in petroleum refining and petrochemicals will be financed entirely by the government-owned companies operating in these sectors. This also applies to some of the large investments needed in the electricity sector to meet growing demand. Furthermore, a substantial volume of loans from the government's specialized credit institutions will be extended to the producing sectors, on the basis of funds made available through repayments of past loans and with no new contributions from the budget. A large share of the allocated funds will finance substantial investments in developing the water resources needed for a growing population, while ways to mobilize private financing will also be considered for this purpose. The project expenditure requirements of the Royal Commission for Jubail and Yanbu, which, in the past, received a large share of the total allocation for economic resource development, will decline, since existing capacities are sufficient to meet the needs for the Fifth Plan period.

TABLE 5.9

Development Agency Expenditures in the Fourth and Fifth Plans

A - Expenditure Structure *

	Fourth Plan		Fifth Plan
	Plan	Actual	
Spending Category	(Percent)	(Percent)	(Percent)
Economic Resources	30.0	20.9	18.5
Human Resources	24.2	33.4	35.4
Health and Social Services	16.3	17.4	16.8
Transport and Communications	13.7	14.8	13.3
Municipalities and Housing	15.8	13.5	16.0
Total : Development Agencies	100.0	100.0	100.0

B - Expenditure Level *

	Fourth Plan (Actual)	Fifth Plan	Increase on Fourth Plan (Actual)
Spending Category	(SR billion)	(SR billion)	(Percent)
Economic Resources	71.4	73.0	2.2
Human Resources	114.2	139.9	22.5
Health and Social Services	59.3	66.1	11.5
Transport and Communications	50.6	52.6	3.9
Municipalities and Housing	46.0	63.2	37.4
Total : Development Agencies	341.5	394.8	15.6

* Including funds provided by the government's specialized credit institutions, mainly from repayment of previous loans.

Human Resources

Facilities for primary and secondary education will be increased in all regions in response to population growth. Funding allocations for technical and vocational training facilities will also increase substantially. Overall, targeted spending in the Fifth Plan is more than 20 percent higher than expenditure during the Fourth Plan period, reflecting the priority given to the development of the Kingdom's human resources.

Health Services

In the health sector, the Plan gives priority to growth in the basic primary health care network in smaller cities and rural areas. Since health services in the major cities are now widely available, further growth in urban demand can be accommodated through relatively small additional investment and by the expansion of private health care.

Transportation and Communications

The great majority of the transportation infrastructure has been completed, so the need for new projects in this sector will be relatively low during the Fifth Plan. However, strong demand for further expansion of postal services and the telephone system will require a large increase in investments in communications facilities. Similarly, in meeting the needs of a high technology society, further investment will be necessary to extend television coverage to the entire country through the use of satellite technology.

Municipalities and Housing

Investment in municipalities will grow strongly during the Fifth Plan, in particular to improve services in smaller cities and towns. Existing excess capacity in the public housing sector will reduce the need for investment in new housing projects during the Fifth Plan.

5.5 GOVERNMENT REVENUES AND FINANCING

The volatility of oil export earnings over the past decade underlines the need to increase government non-oil revenues, so that a more stable income base can be established to finance government activities and reduce the budget deficit.

Progress in increasing non-oil revenues is closely related to the further diversification of the economy, the continued rise in national wealth, and the strengthening of the revenue-gathering institutions. Adjustments in fees for public services where existing fees do not cover the service costs would also contribute to enhanced non-oil revenues. During the Fifth Plan period non-oil revenues are expected to grow at about the same rate as non-oil sector production. Thus, the Fifth Plan establishes a balance between the goals of restoring fiscal soundness in the government sector and of ensuring the well-being of citizens.

At the end of the Fourth Plan a new fiscal policy was implemented, as government revenues used to finance development projects were supplemented by domestic borrowing, instead of further draw-downs of the Kingdom's foreign reserves. This policy will be continued (as necessary) in the Fifth Plan and has several advantages: it supports the continued funding of high priority projects that are essential to the Kingdom's further development; it mobilizes domestic financial resources that would otherwise be idle or invested abroad; and it provides Saudi citizens with new savings opportunities. Furthermore, domestic borrowing through the issuance of development bonds provides a much needed monetary policy instrument. Although the costs of servicing such domestic debt will increase current expenditure, government foreign investment income will not be affected.

5.6 INVESTMENT REQUIREMENTS AND MOBILIZATION OF CAPITAL

5.6.1 Investment Requirements

To achieve the macroeconomic growth targets of the Fifth Plan, an estimated total investment of SR 386 billion will be required. Estimates of the sectoral structure of investment needed to achieve these macroeconomic targets and projected sectoral growth rates in the Fifth Plan are shown in Tables 5.10 and 5.11.

The sectors with the strongest growth potential (agriculture, petrochemicals, other manufacturing, and financial services) are expected to account for about 22 percent of total investment in the economy by 1414/15, compared to about 13 percent one decade earlier. This investment is expected to have strong multiplier effects on other sectors and to make a substantial contribution to the further diversification of the economy. Residential housing will continue to account for a significant share of total investment, reflecting the continuing need for new housing for the growing Saudi population. Housing investment will generate powerful multiplier effects on the manufacturing and other mining sectors. The priority given to extending the supply of water and electricity throughout the Kingdom will require substantial investment in the utilities sector. One quarter of total investment in the Fifth Plan will be allocated to government services to maintain present service standards.

During the Fifth Plan period, major changes in the financing of investment are expected to occur, as the role of the government budget as a source of financing is targeted to decline. The main assumptions underlying these expectations are:

- The government budget is targeted to provide SR 151 billion for investment in transportation facilities, government services (such as schools and hospitals), utilities and other public facilities. Part of these investment expenditures will be financed by development bond issues, if necessary.

- Specialized credit institutions are expected to provide approximately SR 35 billion in investment by recycling repayments of outstanding loans.

- Government-owned companies are expected to provide about SR 56 billion in investment, mainly from retained profits and depreciation charges.

- The private sector is expected to contribute about SR 144 billion of total investment in the Fifth Plan. Financing of this investment will come primarily from retained earnings of private sector companies, private savings, commercial bank loans, and private capital brought back from overseas. In addition, the private sector is expected to purchase part of the development bonds, if issued during the Fifth Plan.

TABLE 5.10

Estimates of Capital Investment by Sector
(in current prices)

	Capital Investment		Share of Total Investment		
	(SR billion)		(Percent)		
	1409/10	1414/15	1404/05	1409/10	1414/15
Producing Sectors	**16.6**	**31.4**	**22.9**	**28.5**	**35.6**
Agriculture	2.5	4.6	1.5	4.3	5.2
Other Mining	0.2	0.6	0.3	0.4	0.7
Manufacturing	**7.8**	**13.4**	**9.7**	**13.3**	**15.2**
Petroleum Refining	1.7	2.4	1.0	3.0	2.7
Petrochemicals	2.6	3.8	2.8	4.3	4.3
Other Manufacturing	3.5	7.2	5.9	6.0	8.2
Public Utilities	3.9	9.3	7.9	6.7	10.5
Construction	2.2	3.5	3.5	3.8	4.0
Service Sectors	**13.4**	**18.2**	**20.8**	**23.1**	**20.6**
Trade	3.8	5.4	5.1	6.6	6.1
Transport, Communications	5.3	5.6	7.8	9.1	6.3
Real Estate	1.4	2.4	3.7	2.4	2.7
Financial and Business Services	1.9	3.4	3.0	3.3	3.9
Community and Personal Services	1.0	1.4	1.2	1.7	1.6
Government Services	14.3	22.3	36.3	24.7	25.2
Crude Oil and Natural Gas	5.6	6.7	8.9	9.7	7.6
Residential Housing	8.1	9.7	11.1	14.0	11.0
Total	58.0	88.3	100.0	100.0	100.0

TABLE 5.11

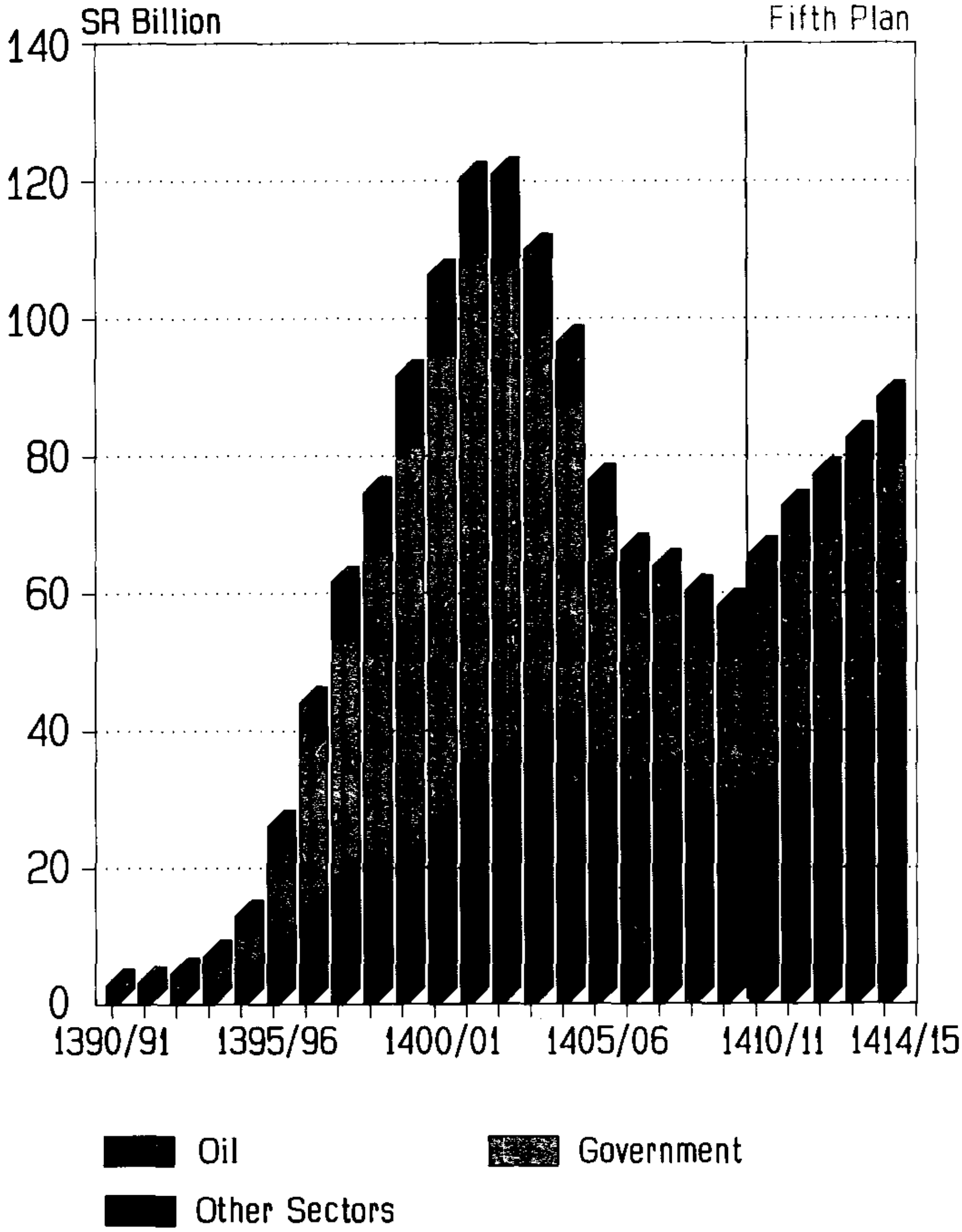
Estimates of Investment Financing Requirements by Sector and Source (SR billion in current prices)

	Total	Government Budget	Specialized Credit Institutions	Government Owned Companies	Private Sector
Producing Sectors	**129.6**	**32.4**	**15.9**	**16.9**	**64.4**
Agriculture	18.4	0.9	6.9	—	10.6
Other Mining	2.6	1.2	—	0.3	1.1
Manufacturing	**54.6**	**1.3**	**9.0**	**13.6**	**30.7**
Petroleum Refining	10.8	—	2.3	6.3	2.2
Petrochemicals	16.5	0.4	2.2	3.6	10.3
Other Manufacturing	27.3	0.9	4.5	3.7	18.2
Public Utilities	39.2	29.0	—	2.3	7.9
Construction	14.8	—	—	0.7	14.1
Service Sectors	**84.9**	**22.5**	**0.6**	**9.2**	**52.6**
Trade	23.3	—	—	0.2	23.1
Transport, Communications	32.2	22.5	0.6	7.2	1.9
Real Estate	9.7	—	—	0.5	9.2
Financial and Business Services	13.5	—	—	0.7	12.8
Community and Personal Services	6.2	—	—	0.6	5.6
Government Services	95.9	95.9	—	—	—
Crude Oil and Natural Gas	30.9	0.2	—	30.7	—
Residential Housing	45.0	—	18.4	—	26.6
Total	**386.3**	**151.0**	**34.9**	**56.8**	**143.6**

Capital investment by source is shown in Figure 5.3, which demonstrates that private investment in the Fifth Plan is expected to be about 24 percent higher than in the Fourth Plan, a level well within the financing capacity of the private sector.

Figure 5.3

Fixed Capital Formation by Main Sector 1390 - 1415



During the Fifth Plan, mechanisms will be considered for the greater involvement of private investment in public sector functions. Areas where such investment may be sought include electricity generation, telephone systems, and the construction of schools.

5.6.2 Mobilization of Capital

The Fifth Development Plan objectives provide opportunities for the private sector to make maximum use of its financial resources. In this regard, the effective mobilization of domestic household savings, financial assets held abroad by Saudi citizens, and retained earnings of private companies, is considered very critical for the financing of investment in the Fifth Plan. This objective must be achieved within the framework of a free market economy, in which individuals and companies choose to deploy their financial assets according to their perceptions of relative risk/reward characteristics of investment opportunities in domestic and foreign markets.

The mobilization of private capital to meet the investment needs of the Kingdom's development strategy will require effectively functioning financial intermediaries and mechanisms for the efficient transfer of resources from sectors with financial surpluses to private companies seeking investment funds. The savings potential of the household sector is substantial, for example, and is currently under-utilized for domestic investment other than private housing. In the Fifth Plan, therefore, measures to accelerate the provision of a wider range of marketable short- and long-term savings instruments will be necessary. Furthermore, the successful transformation of short term financial assets into longer term capital investment needs an effective and competitive financial and banking sector, and a more developed capital market to assist in reducing and sharing risks. Such financial market innovations would provide private sector companies with an attractive and significant complement to the government's specialized credit institutions as a source of finance for long term investment.

An expanded role for the non-banking financial sector will also be important to the mobilization of capital. In developed economies, a large share of private savings is channelled to insurance companies and pension funds, and enters into circulation through the investment activities of those institutions. The licensing of such long term saving and investment activities on a joint venture basis with Saudi institutions would have the important benefit of attracting foreign capital into the Kingdom. Related types of organizations, such as mutual funds or unit trusts, will also be considered.

5.7 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

The significance of foreign trade to the national economy comes from the unique position of Saudi Arabia in the world economy, which is characterized by the following:

- The Kingdom is the world's leading crude oil exporter.
- The Kingdom holds substantial public financial assets abroad in the form of liquid reserves and other investments. The private sector also has its own foreign investments.
- The Kingdom has emerged on the international scene as an exporter of processed goods, and in particular, petrochemicals.

Throughout the past two decades, the rapid growth process has coincided with the establishment of the Kingdom as an important market for the world's major exporting countries. During this period the value of imports into the Kingdom reached SR 2000 billion, and included a wide range of capital goods and services needed to implement the development process, as well as consumption goods catering for the well-being of the population. The emergence of the Saudi economy as a major market for the exports of the industrialized countries greatly helped to overcome international trade imbalances and the economic recession experienced by these economies at the beginning of the last decade.

The entry of most imports into the Kingdom tariff-free and without other barriers emphasizes the Kingdom's strong commitment to the principle of free trade, thus making the Kingdom one of the few countries in the world with a low level of tariffs, at a time when many other countries are experiencing a rising trend of protectionism and are erecting barriers against the Kingdom's exports.

At the beginning of the Fifth Plan period, Saudi Arabia is faced with the problem of a current account deficit that has persisted since the mid 1980s, as the Kingdom's oil export revenues fell in response to falling international oil prices. Despite this decrease in oil revenues, the balance of trade experienced a continuous surplus during the Fourth Plan period. However, the other elements of the balance of payments (trade in services and public and private transfer transactions) have maintained a high level in favor of other countries, at a time when the balance of trade surplus was rapidly declining. As a result, this led to a continuous deficit in the current account which reached its peak in 1404/05, since when it started to decrease in response to the Kingdom's diversification efforts to expand non-oil exports and reduce merchandise imports through import substitution.

Despite all these efforts, the current account deficit continues to present a problem for the future economic growth prospects of the Kingdom and the achievement of its development objectives. The Kingdom's foreign trade strategy in the Fifth Plan, therefore, will be directed towards the attainment of an adequate balance in the net financial and merchandise trade flows between the Kingdom and other countries. Foreign trade will continue to play its important role in the development process, as the share of total exports in GDP is expected to increase because of expanding non-oil exports (see Table 5.12). Furthermore, development efforts in the industrial sector are expected to accelerate import substitution during the Fifth Plan period.

TABLE 5.12

Foreign Trade in the Fourth and Fifth Plans
(based on current prices)

	1404/05	1409/10	1414/15
	percent	percent	percent
Percentage Share of GDP			
Exports	41.3	38.8	42.8
of which : Merchandise Exports	37.6	33.1	35.9
Non-oil Merchandise Exports	1.2	5.4	6.7
Imports of Goods and Services	54.1	43.3	40.9
Percentage Share of Non-Oil GDP			
Imports	82.2	55.1	53.2
of which : Merchandise Imports	51.2	36.8	35.5

Based on the general strategic principle concerning the important relationship between foreign trade and the development process, the Fifth Plan aims to achieve the foreign trade objectives through the following additional policies:

1. **Enhancing the Base of Export-Oriented Industries and Expanding Exports**
   Saudi Arabia has a substantial comparative advantage in hydrocarbon processing and energy intensive industries, as manifested by the success of its petrochemical industries in world markets. The scope of these industries will be further broadened through the development of downstream industries, both to enhance forward linkages within the national economy and to promote exports, with due consideration of the expected changes in the pattern of demand during the Fifth Plan period.

   The exports of some consumer goods and construction materials will continue, and will be supported by special export promotion programs. The recently established Saudi Exports Development Center and the Saudi Company for Export Marketing are expected to be fully operational during the Fifth Plan period.

The policies and programs for export support are expected to achieve continuous structural change in the composition of total exports (see Table 5.13).

TABLE 5.13

Trend in the Structure of Saudi Exports
(based on current prices)

	1404/05	1409/10	1414/15
	percent	percent	percent
Merchandise Exports	90.9	86.4	84.8
of which : Oil Exports	87.9	72.4	69.1
Non-Oil Exports	3.0	14.0	15.7
Services Exports	9.1	13.6	15.2
Total	**100.0**	**100.0**	**100.0**

2. **International Trade Agreements**
The expansion of Saudi exports depends not only on the international competitiveness of these products, but also, more importantly, on easy access to foreign markets. In this context, the Kingdom will aim for the removal of the tariff and other barriers imposed on its exports by other countries, through the conclusion of trade agreements based on mutual interests and reciprocal treatment. In conjunction with its GCC partners, the Kingdom will take all necessary measures to ensure access for its exports to international markets through such bilateral and multilateral trade agreements.

3. **Broadening the Scope of Import Substitution Industries**
The high per capita income and purchasing power in the Kingdom provides a sizeable internal market potentially capable of absorbing many locally produced goods that can substitute for imports. During the Fifth Plan, further development policies will be devoted to import substitution industries through concerted efforts to enhance horizontal and vertical expansion of the manufacturing sector, and the competitiveness of national products, in addition to programs for improving productivity in the private sector.

4. **Accelerating the Process of Economic Integration with the GCC**
Clearly, the process of economic integration will open new horizons for the future development of the Kingdom and will provide economic and social benefits for all GCC member countries. Furthermore, it will establish conditions for the expansion of the region's internal markets and the exploitation of economies of large scale production. Efforts will be made during the Fifth Plan to accelerate the process of economic integration, with particular emphasis on:

- standardization of tariff systems;

- standardization of technical and statistical specifications and standards;

- enhanced coordination of industrial projects.

In addition, the balance of payments position will be strengthened and the current account deficit reduced through adoption of the following policies:

- Pursuing ways of achieving greater economic diversification and broadening private sector export and import substitution capabilities, including exportable services and the domestic provision of services currently being imported (e.g. transport, insurance, internal tourism).

- Increasing the role of national products in the Kingdom's foreign aid and assistance programs provided to other countries and international institutions.

- Encouraging national and foreign capital for investment inside the Kingdom and increasing the flows of such capital into the Kingdom. These flows increased during the latter part of the Fourth Plan and are expected to accelerate further as more private sector investment opportunities emerge within the Kingdom during the Fifth Plan period. In addition, foreign investment in the economy will grow as a result of the Peace Shield and Al-Yamama Offset Programs.

5.8. LONGER TERM ROLE OF THE PRIVATE SECTOR

The Fifth Plan marks a new phase in the Kingdom's development, as it embarks upon a structural adjustment process in which the private sector and the market mechanism in general can be expected to play a leading role. However, the responsibility for designing the adjustment process, in both institutional and operative terms, will remain with the government. Thus, an overriding concern over the Fifth Plan period will be the establishment of institutional and other mechanisms for inducing long term private capital inflows, to create and expand activities that will improve the external balance, both through increased non-oil exports and further import substitution. The Fifth Plan's greater emphasis on rules and incentives appropriate to a more complex market economy is expected to open up a wider range of private sector activity. In this regard, the components of the Kingdom's existing and future economic potential can be identified as a range of advantages available to the private sector, such as:

- locational advantages for high quality infrastructure and opportunities to expand trade with Arab, other Islamic and developing countries in Africa and Asia;

- financial advantages in respect of asset and transaction security, taxation and investment incentives;

- resource advantages for energy intensive and petrochemicals related operations and derivative products;

- increasing opportunities for high technology and research intensive activities;

- increasing availability of a well trained labor force at reasonable costs.

The Kingdom's non-oil GDP is expected to resume its growth pattern of earlier years through the joint efforts of the public and private sectors. The longer term focus of the Fifth Development Plan gives it greater strategic similarity and closer conceptual links to future Plans than to past Plans, which belonged to a different stage in Saudi development. Seen in this light, the Fifth Plan is the first stage of a longer term process making the Saudi economy capable once more of self sustaining and externally balanced growth.