CHAPTER 2

PROGRESS DURING
THE FIFTH DEVELOPMENT PLAN

2. PROGRESS DURING THE FIFTH DEVELOPMENT PLAN

This chapter reviews the progress made during the Fifth Plan period (1410/11 to 1414/15) in terms of economic growth, government revenues and expenditures, employment and international trade. The chapter provides the background for the expected developments in the national economy during the Sixth Plan, which are presented in Chapter 4.

2.1 OVERVIEW

The invasion of Kuwait and the subsequent outbreak of the Gulf war posed enormous organizational and financial challenges to the Saudi economy in the early years of the Fifth Plan. There followed a period of substantial investment activity, as the private sector responded to higher government expenditures in the economy and a rise in consumer spending.

The speed and scale of the post-war recovery provided encouraging confirmation of the adaptive capacity of the Saudi economy and the restoration of private sector confidence. Most significantly, this recovery took place with only a marginal rise in consumer prices. The Kingdom's free trade philosophy, along with the rationalization of economic policies, played an important role in containing inflationary pressures, as the supply of imported goods and services responded rapidly to the increase in demand. This surge in economic activity reduced the private sector's incentive to invest abroad and led to a significant repatriation of Saudi capital and higher domestic liquidity in the Fifth Plan period. One indicator of this high liquidity and investor confidence is the stock market index, which almost doubled in value in the twelve months following the end of the war.

Notwithstanding these positive aspects, however, the consequences of the Gulf war pose serious challenges to the Saudi economy at the start of the Sixth Plan period. Higher than planned oil revenues, arising from the Kingdom's increased OPEC quota, provided only partial cover for the financing needs of the war and its aftermath. Expenditures exceeded revenues in the first three years of the Fifth Plan period, thereby creating a financial burden on the state budget.

The enormous strain on the government finances in the first three years of the Fifth Plan, therefore, had to be reduced, as budget deficits of this magnitude could not be sustained. The budgetary situation was further aggravated by a decline in crude oil prices in 1414/15 to a level more than 30 percent below the OPEC target price. A dedicated effort has since been made to consolidate the budget, with sizable expenditure reductions being made in each of the two remaining years of the Fifth Plan.

The resulting decline in government-induced demand inevitably had a dampening effect on economic growth at the end of the Fifth Plan period, although its effects were limited by the private sector's ability to adapt to lower government spending. Thus, the transition from a primarily budget-driven economy to an economic structure reflecting more autonomous private sector demand and investment activity has been firmly established. Despite the negative impacts of the Gulf war, the private sector has emerged more active, independent and dynamic at the end of the Fifth Plan.

2.2 FIFTH PLAN OBJECTIVES

The major objectives of the Fifth Plan were to:

- develop human resources, thus ensuring a constant supply of manpower, upgrading its quality and improving its efficiency to meet the requirements of the national economy;
- reduce dependence on the production and export of crude oil as the main source of national income;
- continue the restructuring of the Kingdom's economy and the diversification of the economic base, with due emphasis on industry and agriculture;
- concentrate on the qualitative development of existing utilities and facilities by improving their level of performance;
- encourage further private sector participation in socio-economic development.

For the achievement of these objectives, planned allocations by the government in the Fifth Development Plan amounted to about SR 753 billion.

2.3 GOVERNMENT REVENUES AND EXPENDITURES

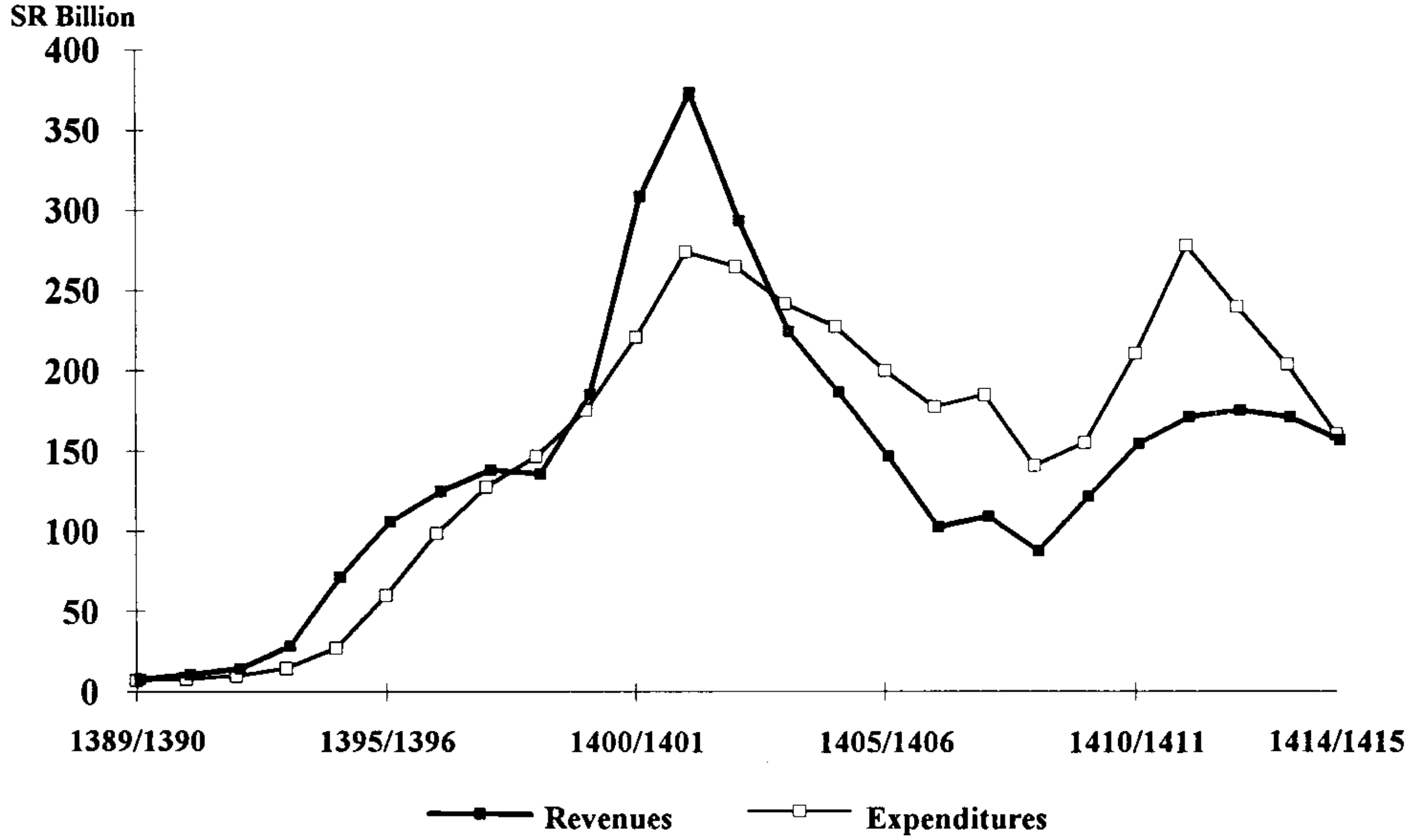
The onset of the Gulf crisis and the Kuwait liberation war early in the Fifth Plan period caused a substantial deviation of both government revenues and expenditures from their planned paths. As a result, a fiscal strategy aimed at rationalizing government expenditure was adopted. The firm implementation of this strategy succeeded in reducing the budget deficit in the later years of the Fifth Plan (see Figure 2.1).

2.3.1 OIL AND NON-OIL REVENUES

In the first year of the Fifth Plan, the Kingdom responded to the cutback in world oil supplies (due to the Gulf war) by raising its crude oil production. As a result, the oil revenue position changed dramatically. Although the initial production increase was sustained, falling oil prices led to a decline in revenues in the last two years of the Plan.

Non-oil revenues, on the other hand, showed a downward trend in the early years of the Fifth Plan, as the draw-down in reserves reduced the flow of investment income from abroad. With the recovery of economic activity after the war, however, non-oil revenues began to rise again.

Figure 2.1
Government Revenues and Expenditures (at current prices)



2.3.2 RECURRENT AND PROJECT EXPENDITURES

Government expenditure, which had reached a minimum level in the fourth year of the Fourth Plan (1408/09), rose moderately in the final year of that Plan period (1409/10). There followed a dramatic increase in expenditure in response to the Gulf crisis, so that in the second year of the Fifth Plan (1411/12) government expenditure rose to its highest level in ten years (see Figure 2.2).

Despite the similar levels of government expenditure at the beginning of the Third and Fifth Development Plans, there were significant differences in the composition of expenditure between these two periods (1401/02 and 1411/12). Whereas at the beginning of the Third Development Plan, the build-up of the Kingdom's infrastructure required a high level of project expenditure, the cost of the war was reflected in the high share of recurrent expenditure in the first two years of the Fifth Plan. The pronounced expansion of project expenditure in the third year (1412/13), however, highlights the Kingdom's efforts to strengthen its infrastructure through previously delayed priority projects and to speed up economic recovery.

After considerable efforts to consolidate the budget, recurrent expenditure had returned to its level of five years earlier by the end of the Fifth Plan. Project expenditure, on the other hand, was marginally higher than at the end of the Fourth Plan (1409/10), because of the conscious effort to expand the country's infrastructure to meet the needs of a growing population and to replace equipment and facilities installed during the rapid development of the Second and Third Plan periods.

Total government expenditure during the Fifth Plan period, including non-civilian expenditure, reached SR 1,090 billion, or 44 percent more than planned spending for the period. Of this total, project expenditure accounted for 26 percent.

2.3.3 DEVELOPMENT EXPENDITURE

Despite the enormous strain on the financial resources of the Kingdom, total spending by the development agencies reached 91.7 percent of the planned allocations (see Table 2.1). Spending priorities changed, however, particularly at the beginning of the plan period, in response to unforeseen circumstances and the government's ongoing concern for the welfare of citizens. Thus, allocations for the development of human resources and for health and social services were increased significantly, while expenditures on transportation and communications facilities, economic resources development and municipalities and housing were lower than planned.

Figure 2.2
Recurrent and Project Expenditure (at current prices)

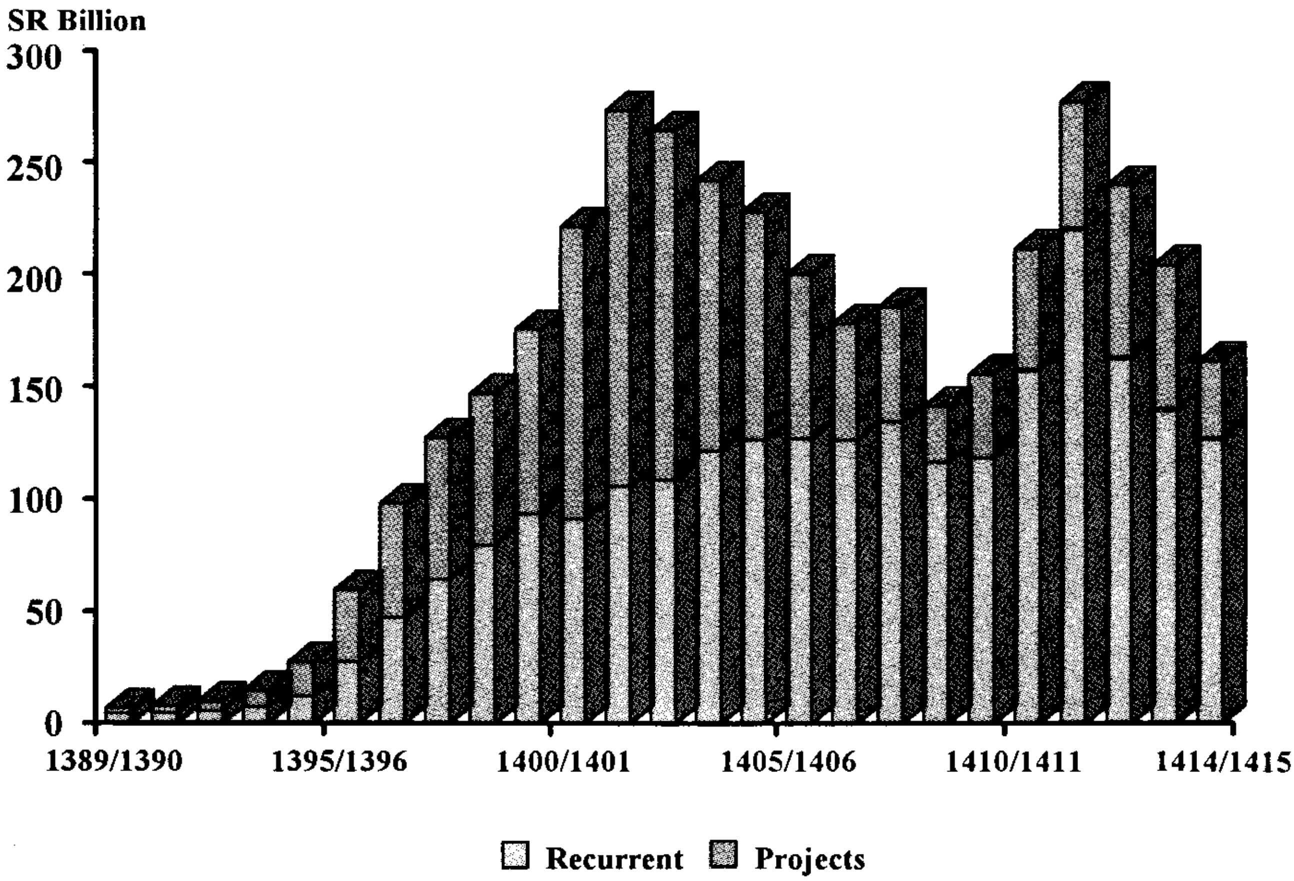


Table 2.1

ALLOCATION OF DEVELOPMENT EXPENDITURE IN THE FIFTH PLAN ★

Spending Category	Percentage Distribution		Actual Expenditure ★★	
	Plan %	Actual %	Value (SR billion)	As percent of Plan -- %
Economic Resources	15.8	10.6	34.7	61.4
Human Resources	39.1	47.3	155.0	111.1
Health and Social Services	17.9	19.3	63.3	99.0
Transport and Communications	14.7	12.9	42.4	80.6
Municipalities and Housing	12.5	9.9	32.4	72.3
Total	100.0	100.0	327.8	91.7

★ Excluding loans from the government's specialized credit institutions

★★ Amounts for the last year of the Fifth Plan are estimates.

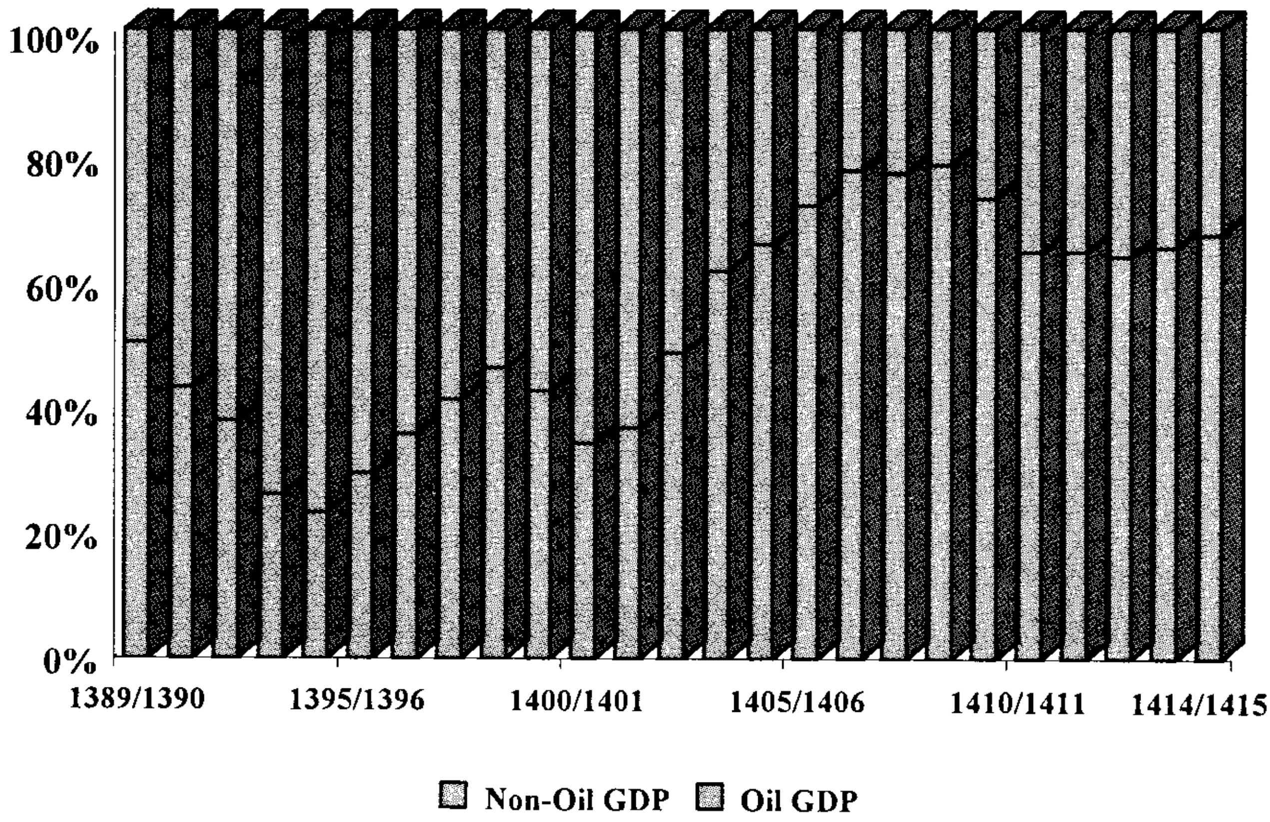
The high standards of infrastructure and government services already achieved in all development sectors allowed for the postponement of some projects targeted in the Fifth Development Plan. Project expenditure was reduced by varying amounts in all development agencies, so that overall, this category of spending reached 41 percent of the planned allocations. Funds initially identified for projects had to be channeled into recurrent expenditure, which reached a level almost SR 34 billion higher than planned.

2.4 GROSS DOMESTIC PRODUCT IN THE FIFTH PLAN

A change in the structure of the Kingdom's economy over any particular period is profoundly affected by price and volume changes in the international oil market. Although the rise in crude oil production at the start of the Fifth Plan was particularly sharp, subsequent price fluctuations limited the impact of this volume increase on the structural composition of GDP. Thus, the oil sector's share (based on current prices) rose from 30 percent to 36.6 percent over the course of the Plan (see Figure 2.3).

The sustained expansion in crude oil production at the start of the Fifth Plan was sufficient to ensure that Gross Domestic Product grew at an average annual rate of 4.1 percent (measured in constant 1409/10 prices) over the five-year period. At the same time, growth in the non-oil economy was heavily influenced by the annual fluctuations in government expenditure, which temporarily reversed in the earlier years the long-term downward trend in the relative weight of government expenditure in the economy.

Figure 2.3
Gross Domestic Product by Main Sector
(at current prices)



In real terms, the non-oil economy grew at the rapid rate of 8.6 percent in the first year of the Fifth Plan period, primarily in response to the Gulf war-related increase of government expenditure and the consequent rise in the government contribution to the non-oil GDP at that time. In the following years, however, the decline in government expenditure had a restraining influence on economic growth, to the extent that the non-oil sectors' value added grew at an average annual rate of 2.1 percent during the Fifth Plan period as a whole. Table 2.2 presents a sectoral breakdown of GDP and the growth in the Kingdom's economy over the Fifth Plan period.

Notwithstanding the relatively slow rate of economic growth for the non-oil sectors over the period as a whole, a number of positive features confirm that the long term structural transformation of the Saudi economy is continuing:

- First, particularly significant to the continued diversification of the Kingdom's economy was the relatively strong average annual growth of 4.4 percent of "other" manufacturing industry. As a result, its share of value added in the non-oil sectors (non-oil GDP) rose from 5.3 percent to 6.2 percent during the Fifth Plan period in current price terms.
- Second, there is evidence of a continued decline in the private sector's dependence on government expenditure, as private non-oil sectors' contribution to GDP continued to grow at an average annual rate of 2.9 percent in the third and fourth years of the Plan, when government expenditure fell by 5.2 percent and 16.6 percent respectively.

Table 2.2

Gross Domestic Product by Sector in the Fifth Plan
(at constant 1409/10 prices) ★

	Value Added (SR billion)		Average Annual Growth (percent)	
	1409/10	**1414/15 ★★**	**Target**	**Actual**
Producing Sectors	**83.0**	**93.2**	**5.7**	**2.4**
Agriculture, Forestry, Fishing	22.7	26.4	7.0	3.1
Other Mining, Quarrying	1.8	2.3	4.0	4.9
Manufacturing	**25.2**	**31.1**	**6.8**	**4.3**
Petroleum Refining	9.4	13.5	5.4	7.5
Petrochemicals	4.0	3.0	8.0	(5.6)
Other Manufacturing	11.8	14.6	7.5	4.4
Electricity, Gas, Water	0.8	0.9	6.9	4.5
Construction	32.5	32.5	3.8	0.0
Service Sectors	**83.7**	**89.8**	**3.6**	**1.4**
Trade, Restaurants, Hotels	26.1	27.8	3.0	1.3
Transport, Communications	23.1	25.0	3.2	1.6
Finance, Insurance, Real Estate and Business Services	**23.1**	**25.2**	**5.7**	**1.8**
Real Estate	6.1	6.9	2.8	2.5
Other	17.0	18.3	6.6	1.5
Community and Personal Services	11.4	11.8	1.7	0.7
Government Services	57.8	66.4	0.8	2.8
Non-Oil Sectors	**224.5**	**249.4**	**3.7**	**2.1**
Crude Oil and Natural Gas	83.8	129.3	2.2	9.0
Other Items (1)	2.5	2.1	---	---
Gross Domestic Product	**310.8**	**380.8**	**3.4**	**4.1**

★ Development of real growth of GDP at 1409/10 prices should not be compared with figures presented in current prices, which reflect the cash value of current transactions in the economy.

★★ Estimate

(1) Import duties less imputed bank service charges;( ) Figures in brackets denote negative values.

Table 2.3 shows the relative GDP contributions of the oil and non-oil sectors during the Fifth Development Plan period. In contrast to Table 2.2 where it was included as part of the manufacturing sector, petroleum refining in Table 2.3 has been included as part of the oil sector so that the main sectors (oil,non-oil) can reflect the contribution to the GDP in current prices .

Table 2.3

Gross Domestic Product in the Fifth Plan : oil and non-oil sectors

Sector	Value Added at Current Prices (SR billion)		Average Annual Growth Rates at 1409/10 prices (%)	
	1409/10	1414/15	Target	Actual
Non-Oil Sectors	**215.0**	**276.3**	**3.7**	**1.9**
Government Services	57.8	77.0	0.8	2.8
Other Non-Oil Sectors	157.2	199.3	4.5	1.5
Oil Sector *	**93.3**	**161.1**	**2.7**	**8.9**
Other Items **	2.5	2.7	—	—
Gross Domestic Product	**310.8**	**440.1**	**3.2**	**4.1**

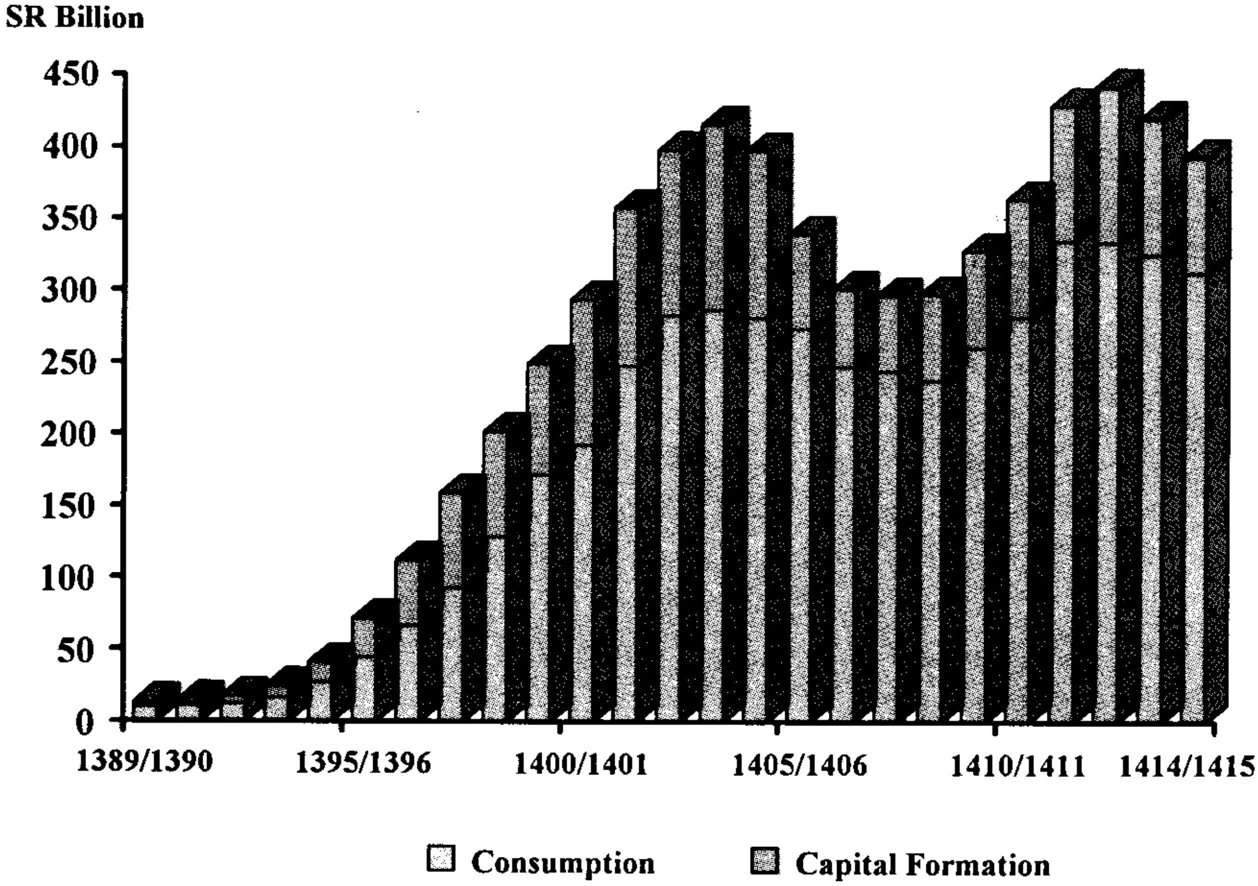
★ Oil Sector is defined in this table according to the definition adopted by the CDS, which includes petroleum refining. Since petroleum refining is related to the other economic sectors, it will be included as part of the non-oil producing sectors in the other tables.

★★ Import duties less bank service charges.

2.5 EXPENDITURE ON GROSS DOMESTIC PRODUCT

The Gulf crisis and its aftermath not only caused major changes in the composition of supply; it also severely affected the demand side of the economy. In 1410/11 and 1411/12, there was a surge in demand for both government consumption and investment expenditure, which induced more private consumption. The rapid increase of government investment in the early years of the Plan was offset by a reduction in private investment, which had to be expected in such an uncertain environment. During the adjustment period after the Kuwait liberation war, the government reduced its expenditure to pre-war levels, while the private sector, regaining confidence, increased investment considerably, particularly in real estate. Thus, this period was characterized by huge fluctuations in domestic demand (see Figure 2.4).

Figure 2.4
Domestic Final Demand (at current prices)



In real terms, private consumption grew at an average annual rate of 4.1 percent compared to the targeted growth rate of 3.5 percent, at which a constant per capita income is expected to be maintained. Government consumption fell at an average annual rate of 3.3 per cent in real terms, compared to the targeted growth rate of 1.5 percent, due to the decline in government expenditure in the later years of the Fifth Plan which limited the growth in total consumption to an average annual rate of 1.1 percent (see Table 2.4).

Growth rates calculated over the entire Plan , however, do not adequately reflect the substantial changes that took place in the individual years and give no impression of the major disruptions the Saudi economy experienced at the start of the Fifth Plan. For example,

- government consumption measured in constant prices increased by 7.9 percent in 1410/11 and by 9.1 percent in 1411/12. Over the remaining years of the plan period, it declined by an average annual rate of 10 percent to the level reached in 1414/15;
- the combined effect of these developments was that real consumption expenditure as a whole grew at an average annual rate of 5.4 percent in the first two years, but declined at the average annual rate of 1.7 percent over the remaining three years of the Fifth Plan.

Table 2.4

Expenditure on Gross Domestic Product
(at constant 1409/10 prices) ★

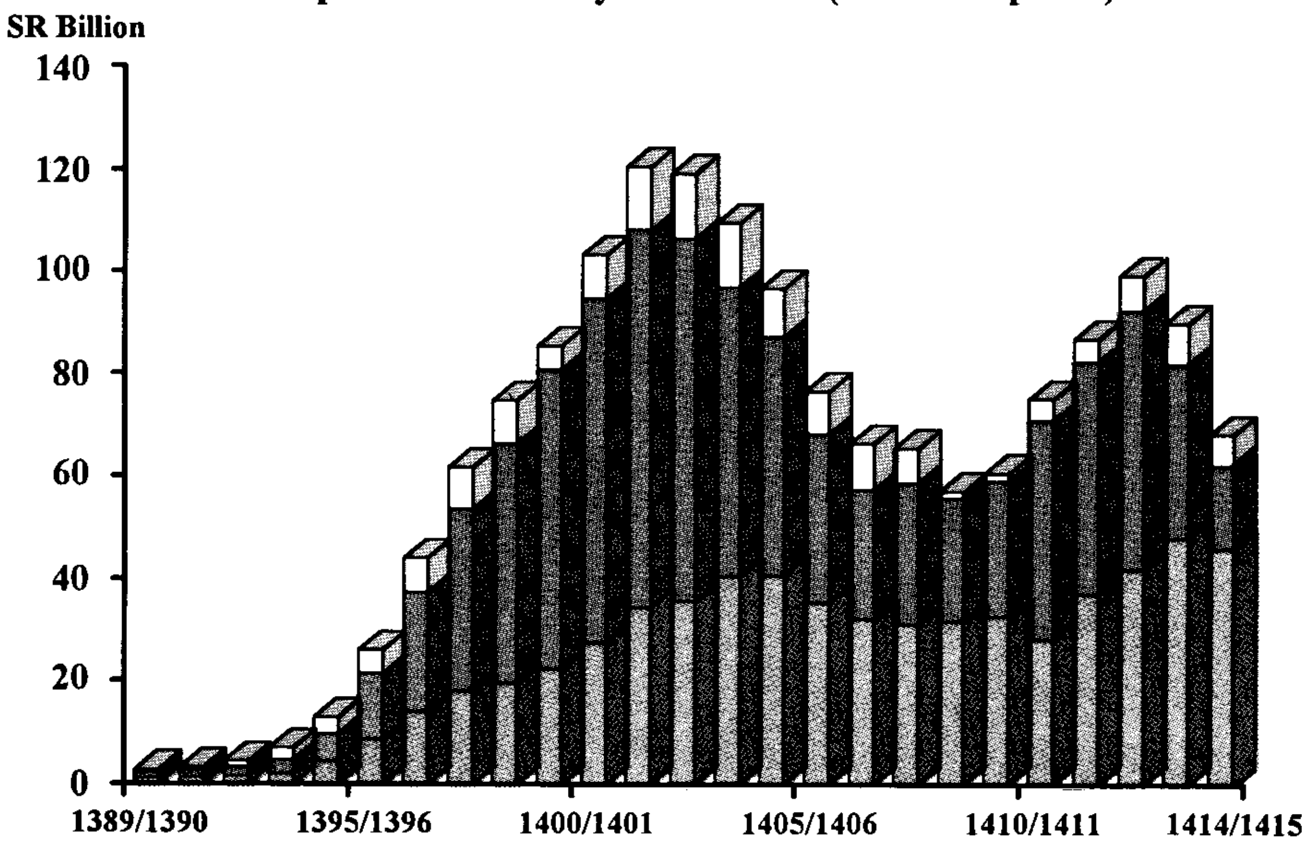
	Expenditure (SR billion)		Average Annual Growth (percent)	
	1409/10	1414/15	Target	Actual
Consumption	**259.3**	**273.5**	**2.6**	**1.1**
Government	114.3	96.6	1.5	(3.3)
Private	145.0	176.9	3.5	4.1
Gross Fixed Capital Formation	**60.4**	**54.8**	**7.5**	**(1.9)**
Oil	1.5	4.9	3.2	26.3
Government	26.3	13.7	8.6	(12.2)
Private	32.6	36.2	6.8	2.1
Change in stocks	6.8	(3.9)	---	---
Domestic Final Demand	326.5	324.4	3.1	(0.1)
Net Exports	**(15.7)**	**56.4**	**---**	**---**
Exports	120.3	184.1	4.0	8.9
Imports	136.0	127.7	3.2	(1.2)
Gross Domestic Product	**310.8**	**380.8**	**3.4**	**4.1**

★ The values shown for real growth of expenditure components are measured at 1409/10 prices and are not comparable with corresponding values at current prices.

( ) Figures in brackets denote negative values

Investment in the oil sector was substantially higher at the end of the Fifth Plan compared to its level at the beginning. Uncertainty imposed by the Gulf war deterred private investment in the first year of the Plan, but private investment activity rebounded again growing by 20.8 percent in 1411/12 and by 6.0 percent in 1412/13. By the end of the Fifth Plan in 1414/15, private investment had reached a higher level than before the war. Government investment, on the other hand, had to respond to the particular challenges at the time and reached a peak in 1412/13 at more than double the expenditure of 1409/10 (see Figure 2.5).

Figure 2.5
Fixed Capital Formation by Main Sector (at current prices)



2.6 EMPLOYMENT

Total civilian employment increased by 818,300 persons during the Fifth Plan period, from 6,049,400 in 1409/10 to 6,867,700 in 1414/15, or at an average annual rate of 2.6 percent.

The total number of Saudis employed rose by 402,700 in the Fifth Plan period, from 1,981,500 in 1409/10 to 2,384,200 in 1414/15, or at an average annual rate of 3.8 percent. Thus, not only did most Saudis entering the labor force succeed in finding employment in the Fifth Plan period, but the Saudi share of total employment also increased from 32.8 percent to 34.7 percent over the Fifth Plan period.

Sectoral employment trends in the Fifth Plan period are shown in Table 2.4. In absolute terms, the largest employment increase occurred in the community and personal services sector, where an additional 326,200 workers were employed. Other significant increases were in the construction sector (144,000), the trade sector (114,800), government services (106,500) and other manufacturing (69,100).

Employment growth was highest in the services sectors, particularly in community and personal services, Where Productirity is Lowest (in terms of value added per worker). As a result, productivity in the non-oil sectors of the economy as a whole continued to decline, notwithstanding the Fact that productirity in the producing sectors grew at a moderate rate.

Table 2.5

Employment by Sector in the Fifth Plan
(in thousands)

	1409/10	1414/15	Change 1409/10-1414/15
Producing Sectors	**1,874.8**	**2,088.9**	**214.1**
Agriculture, Forestry, Fishing	393.2	377.2	(16.0)
Other Mining, Quarrying	3.7	4.4	0.7
Manufacturing	**494.7**	**566.9**	**72.2**
Petroleum Refining	15.2	16.8	1.6
Petrochemicals	6.5	8.0	1.5
Other Manufacturing	473.0	542.1	69.1
Electricity, Gas, Water	66.5	79.7	13.2
Construction	916.7	1,060.7	144.0
Service Sectors	**3,414.8**	**3,906.4**	**491.6**
Trade, Restaurants, Hotels	921.9	1,036.7	114.8
Transport, Communication	274.9	319.9	45.0
Finance, Insurance, Real Estate, and Business Services	324.6	330.2	5.6
Community and Personal Services	1,893.4	2,219.6	326.2
Government Services	**711.2**	**817.7**	**106.5**
NON-OIL SECTORS	**6,000.8**	**6,813.0**	**812.2**
Crude Oil and Natural Gas	48.6	54.7	6.1
Total	**6,049.4**	**6,867.7**	**818.3**

2.7 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

The invasion of Kuwait at the start of the Fifth Plan Prompted some significant and contradictory changes in the Kingdom's foreign trade and balance of payments positions. On the one hand, the sharp and sustained rise in the value of oil exports at the start of the period resulted in an average annual surplus of SR 74.5 billion in the trade balance. On the other hand, the substantial costs of the war and the enormous outflow of related payments had a dramatic negative impact on the overall balance of payments position, so that the average annual current account deficit during the Plan period reached SR 53.7 billion (Table 2.6).

Table 2.6

FOREIGN TRADE AND BALANCE OF PAYMENTS IN THE FIFTH PLAN
(SR billion in current prices)

	1409/10 Base Year	1410/11	1411/12	1412/13	1413/14	1414/15 ★	Fifth Plan Annual Average
Merchandise Exports (fob)	106.3	166.3	179.0	176.2	168.2	157.8	169.5
Merchandise Imports (fob)	72.0	80.5	97.3	113.3	96.0	87.9	95.0
Trade Balance	34.3	85.9	81.7	62.9	72.2	69.9	74.5
Net Services and Transfers	(70.0)	(101.3)	(185.0)	(141.4)	(125.4)	(88.2)	(128.7)
Current Account	(35.7)	(15.4)	(103.3)	(78.5)	(53.2)	(18.3)	(53.7)
Relative Significance of Foreign Trade (%)							
Exports of goods and services as a percent of GDP	38.7	46.8	44.6	43.1	41.7	40.9	43.4
Imports of goods and services as a percent of non-oil GDP	60.6	61.8	64.7	63.6	51.8	45.2	57.2
Current Account as per cent of GDP	(11.5)	(3.9)	(23.4)	(17.3)	(11.6)	(4.1)	(12.3)

★ MOP estimates
( ) Figures in brackets denote deficits

Over the Fifth Plan period exports of goods and services as a percentage of GDP rose from 38.7 percent in 1409/10 to 40.9 percent in 1414/15, while imports of goods and services as a percentage of non-oil GDP rose from 60.6 percent in 1409/10 to 64.7 percent in 1411/12, although this ratio declined to 45.2 percent by the end of the Fifth Plan period. This decline in imports reflects a growing reliance on domestically produced goods and services.

At the same time, however, steps were taken in the Fifth Plan period to address the balance of payments constraint facing the Kingdom, as large-scale drawings from the Kingdom's foreign reserves could not finance a rising current account deficit indefinitely. The success of these measures can be seen in the decline in the current account deficit as a percentage of GDP in three of the five years, so that by the end of the Fifth Plan period, this ratio had fallen to 4.1 percent from its level of 11.5 percent at the start of the Plan. However, the decline of oil prices and the increase in import prices relative to export prices, as well as the rise in transfers abroad, prevented any further reduction in the current account deficit during the last two years ofthe Fifth Plan.

2.8 INFLATION

Over the course of past development plans, the Kingdom has managed to achieve respectable economic growth accompanied by low inflation. The government's resolve to control inflation was severely tested by the rapid expansion of domestic demand in the aftermath of the invasion of Kuwait. This pressure was particularly strong in the third year of the Fifth Plan, when the government responded by reducing prices for essential commodities and utility services. As a result, consumer prices rose at the very low average annual rate of only 2.5 percent over the five-year period (see Figure 2.6).

There was some variation in the rate of price increase between individual sectors and between the earlier and later years of the Plan. In general, prices rose more sharply in the early years and were followed by lower inflation rates in the later years. Overall, the annual average rate of inflation, as measured by the non-oil GDP deflator, reached 3.2 percent for the Fifth Plan period as a whole.

Figure 2.6
Consumer Price Index