CHAPTER 4

THE NATIONAL ECONOMY
IN THE SIXTH DEVELOPMENT PLAN

4. THE NATIONAL ECONOMY IN THE SIXTH DEVELOPMENT PLAN

This chapter discusses the development of the Kingdom's economy during the Sixth Development Plan, in terms of the expected future growth in Gross Domestic Product (GDP), its sectoral components and the investment needed to generate economic growth. It also examines likely future conditions for foreign trade and the balance of payments.

4.1 DEVELOPMENT OBJECTIVES FOR THE NATIONAL ECONOMY

The macroeconomic strategy for the Sixth Development Plan has been formulated in accordance with the General Objectives and Strategic Principles approved by the Council of Ministers (Decree No. 142 dated 19/11/1413), taking into account the economic conditions prevailing at the time of the Plan's preparation. This strategy will continue to achieve the Kingdom's long term objectives for the national economy. Accordingly, the Sixth Development Plan gives priority to the resumption of moderately rapid but steady economic growth and achievement of internal and external balances through the progressive elimination of both the budget deficit and the current account deficit. These priorities will be pursued through the continued structural diversification of the Kingdom's economy to create more employment opportunities for Saudi nationals, and the development of practical policies for privatization and alternative methods of financing some government services. The Sixth Development Plan also attributes to the private sector an important role in mobilizing its resources for the development of the national economy. The main themes of the Sixth Plan are to increase the rate at which non-Saudis are being replaced by Saudi nationals (Saudiization), the opening up of more opportunities for private sector investment and the achievement of greater economic efficiency in the government and private sectors.

More specifically, the macroeconomic objectives of the Sixth Plan include the following:

- real average annual growth of 3.9 percent in the non-oil sectors' contribution to GDP, compared to the 3.2 percent growth rate targeted in the Fifth Plan period;
- total investment growing in real terms at an average annual rate of 8.5 percent and amounting to more than 18 percent of GDP;
- growth in non-oil merchandise exports at an average annual rate of 12 percent in current prices;
- an increase in the government's domestic non-oil revenues;
- the progressive elimination of both the budget deficit and the balance of payments deficit on current account;
- a balanced government budget by the end of the Plan period and the rationalization of government expenditure.

The steady expansion of the economy throughout the Sixth Plan will be supported by a broad range of fiscal, regulatory and institutional measures to which a positive response from the private sector is anticipated. These measures will include:

- a pronounced shift in the government budget from consumption to investment expenditure;
- providing opportunities for private sector investment through the gradual and selective use of alternative financing options and privatization initiatives;
- the mobilization of the private sector's financial assets by broadening the domestic capital market;
- reducing the number of low-skilled workers and increasing the capability of the Saudi labor force in order to realize productivity improvements.

4.2 IFISCAL AND MONETARY POLICIES

4.2.1 FISCAL POLICY

The objectives of fiscal policy are:

- to achieve a positive GDP growth rate, thereby increasing the nation's wealth, and to create new job opportunities;
- to maintain living standards by keeping inflation as low as possible and below the rate of economic growth;
- to direct government expenditures towards the expansion and diversification of the economic base and improvements of public services.

To achieve these objectives, the policies of the Sixth Plan will concentrate on the following:

1- Structuring of Government Expenditures

a) The balance between government revenues and expenditures will be gradually improved during the Plan period, through both revenue increases and reductions in expenditures.

b) The budget deficit will be reduced to the minimum possible level over the Sixth Plan period by rationalizing recurrent expenditures and by increasing government revenues.

c) Spending will be kept within the overall limits of the approved budget during the fiscal year, with any unforeseen increase in a government agency's expenditure on specific projects and programs to be met by transfers from that agency's other program or project allocations or by adjusting project implementation periods in conformity with the annual financial resources available to each government agency.

d) The proportion of total government spending allocated for investment and capital expenditure purposes will be increased, whether on new projects and programs or on the maintenance and renovation of existing facilities.

e) Innovative ways will be introduced to encouraging the private sector to implement and finance some public sector projects, thereby providing profitable business opportunities for the private sector and improving the productivity and efficiency of these projects.

f) The adjustment in local utility and fuel prices is aimed to reflect actual costs and to cover maintenance, improvement and expansion costs in line with rising demand in all cases, social stability will be preserved, as lower income groups will not be deprived of the benefits of these services at lower prices compared to the high-income groups..

2- Subsidies and Loans

a) Subsidies (direct and indirect) which the government renders for a wide variety of goods and services will be reviewed and rationalized in order to increase the self reliance of the subsidized sectors. In all government agencies effective measures will be adopted to reduce production cost of public services. Prices of public goods and services will be kept over the level of its economic costs except in rare cases.

b) The development funds will continue to play their positive role in providing loans for individuals and companies, provided that the total value of loans is within the limits of repayments. All necessary government actions will be taken to support the funds in collecting their loans, so that they will be able to provide new loans and continue to play their roles based on their own resources, while taking into consideration the following:

- Loans should be linked to the rate of employment of Saudi nationals.
- Loans should also be linked to the use of local materials and products in the implementation and operation of projects.

4.2.2 MONETARY POLICY

Objectives

The objectives of monetary policy are:

(1) to maintain stable prices as a prerequisite for achieving sustainable economic growth;

(2) to maintain the exchange rate of the Saudi Riyal as a source of strength for the Kingdom's balance of payments position;

(3) to ensure stability of the banking system and to enhance its efficiency and effectiveness;

(4) to encourage stability and orderly growth in the domestic capital markets;

(5) to maintain reasonable liquidity in the economy so as to avoid inflation and achieve balanced economic growth.

To achieve the above objectives, the following measures shall be adopted:

a) Close coordination between monetary and fiscal policy will be maintained.

b) Prices will be stabilized as much as possible by maintaining the purchasing power of the Saudi Riyal.

c) Confidence in the Saudi Riyal will be enhanced by maintaining its value on the foreign exchange markets, in line with economic policy objectives and in a manner that encourages both national and foreign investment.

d) Sufficient liquidity will be provided to the domestic economy to cater for actual needs and to avoid inflation.

e) The regulation of the banking system will be designed to ensure its soundness, to maintain its resources and to promote its support of the national economy.

f) The banking system will be supported by removing the constraints that impede the flow of bank credits to the private sector, while the rules and regulations covering bank lending will be further developed. Furthermore, Saudization will be encouraged in banks and financial institutions.

g) The Credit Risks Center established by SAMA will be supported, so as to increase the accuracy and quality of data obtained by the commercial banks in this respect.

h) Banking control methods will be improved, so as to protect customers and secure their deposits on the one hand, and to protect the banks by ensuring the proper use of resources on the other.

i) The information systems and computer services of SAMA and its branches will be developed by utilizing modern computer technology, and the banks encouraged to use state-of-the-art technology to improve the efficiency of customer services.

j) Savings and capital formation will be encouraged through the development and of appropriate savings and investments channels.

k) Stability of the Saudi stock market will be encouraged and price fluctuations kept within reasonable margins, so as to minimize speculation and encourage citizens to use the stock market as an appropriate tool for investing their savings, thereby transforming them into potential resources for financing development projects in the Kingdom.

4.3 GROSS DOMESTIC PRODUCT IN THE SIXTH PLAN

An important element of the planning process is the determination of expected growth paths for the economy during the plan period. These targets reflect the planned scope and scale of government activities and the anticipated response from the private sector. They also present a comprehensive and consistent picture of the planned development of the Kingdom's economy at the macroeconomic level. Finally, they reflect the expected impact of policies that will be adopted to achieve the overall Sixth Plan objectives for structural change and economic diversification, and for the overall welfare of the nation (Figure 4.1).

4.3.1 GROWTH TARGETS FOR THE OIL AND NON-OIL SECTORS

The Kingdom's national economy is expected to grow at an average annual rate of 3.8 percent (in 1409/10 constant prices) during the Sixth Plan period, resuming its previous moderate and sustainable growth path after the rapid growth experienced during the first two years of the fifth plan, The average annual growth rate of the GDP during the fifth plan (in 1409/10 constant prices) was 4.1% owing to the major expansion in oil production at the begining of the Plan period.

The non-oil sectors of the economy are expected to grow at an average annual rate of 3.9%. This will have strong positive implications on the achievement of the economic diversification objective and will also imply the creation of employment opportunities for the rapidly growing population.

The oil GDP is expected to grow at an average annual rate of 3.8% (See table 4.1), based on the expected developments in the world oil markets where the most recent forecasts indicate to increase of oil demand and prices. This will improve the conditions for achievement of the Sixth Plan growth targets.

Figure 4.1
Gross Domestic Product by Main Sector (at current prices)

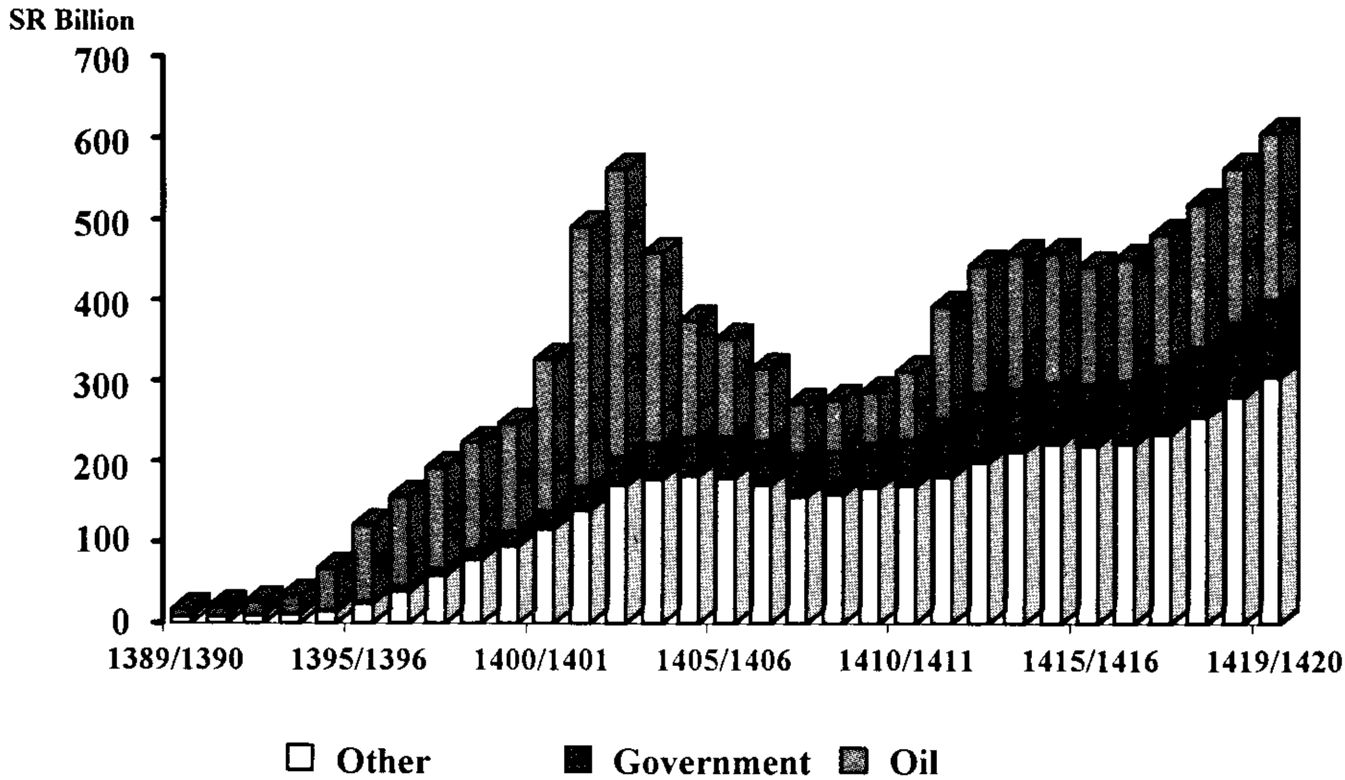


Table 4.1

Gross Domestic Product in the Sixth Plan: Oil and Non-Oil Sectors (at constant 1409/10 prices) ★

Main Sectors	Value Added (SR Billion) 1414/15	Value Added (SR Billion) 1419/20	Average Annual Growth (Percent)
Non-Oil Sectors	235.9	285.1	3.9
- Other Non-Oil Sectors	169.5	209.3	4.3
- Government Services	66.4	75.8	2.7
Oil Sector ★★	142.8	172.5	3.8
Other Items ★★★	2.1	1.0	---
Gross Domestic Product	380.8	458.6	3.8

★ GDP contributions valued in 1409/10 prices are not comparable to their counterparts valued in current prices.

★★ According to the CDS definition, this table includes petroleum refining as part ofthe oil sector. In other tables, petroleum refining is included as a component of the non-oil producing sectors.

★★★ Import duties less imputed bank service charges

4.3.2 SECTORAL GROWTH TARGETS

Longer term efforts to diversify the structure of the economy will continue to be a key factor guiding development in the Sixth Plan. A necessary condition for further structural change will be the ability of Saudi industry to maintain and further improve its competitiveness in international and domestic markets, through higher productivity and the attainment of high quality standards. An increase in world economic activity will open up new export opportunities. The growing domestic market will provide more opportunities for import substitution, which if exploited, will contribute to the strengthening and structural transformation of the economy. Specific strategies and opportunities for the growth of the private sector, including privatization, are discussed in Chapter 5.

All sectors are expected to show positive growth trends, with the producing sectors growing at an average annual rate of 4.2 percent, and the service sectors at 4.4 percent (Table 4.2). The expected stronger growth of services can be partly explained by their slowdown during the Fifth Plan period, when output of the service sectors virtually stagnated. The service sectors are now expected to benefit from a return to a more normal civilian structure of domestic demand.

Agriculture

The Sixth Plan is expected to be a period of transition for the agricultural sector. Production will shift away from large-scale crop production using substantial volumes of scarce water resources, towards high value-added crops produced mainly in areas which have renewable water resources and in greenhouses to serve rapidly growing demands for fresh vegetables and fruits. Because of this change, agricultural output is expected to grow at an annual rate of 3.1 percent during the Sixth Development Plan.

Mining and Quarrying

Thes sector in expectecl to grow at an average annual rate of 9 percent depending mainly on the developments of the construction sector. Development of the mining ond quarrying sector entails great efforts to be devoted to mining activties other than gold. such efforts will give results by the end of the sixth plan period.

Table 4.2

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

Sectors	Value Added (SR Billion)		Average Annual Growth (Percent
	1414/15	1419/20	
Producing Sectors	**93.2**	**114.5**	**4.2**
Agriculture, Forestry, Fishing	26.4	30.8	3.1
Other Mining, Quarrying	2.3	3.5	9.0
Manufacturing	**31.1**	**39.5**	**4.9**
- Petroleum Refining	13.5	16.4	3.9
- Petrochemicals	3.0	4.5	8.3
- Other Manufacturing	14.6	18.6	4.9
Electricity, Gas, Water	0.9	1.2	5.5
Construction	32.5	39.5	4.0
Service Sectors	**89.8**	**111.2**	**4.4**
Trade, Restaurants, Hotels	27.8	37.6	6.2
Transport, Communication	25.0	28.9	2.9
Finance, Insurance, Real Estate and Business Services	**25.2**	**30.7**	**4.1**
- Real Estate	6.9	8.1	3.3
- Other	18.3	22.6	4.3
Community, Social and Personal Services	11.8	14.0	3.4
Government Services	66.4	75.8	2.7
Non-Oil Sectors	**249.4**	**301.5**	**3.9**
Crude Oil and Natural Gas	129.3	156.1	3.8
Other Items (1)	2.1	1.0	---
Gross Domestic Product	**380.8**	**458.6**	**3.8**

★ Not comparable to sectoral GDP contributions in current prices

(1) Import duties less imputed bank service charges.

Oil Refining

The stimulus for the 3.9 percent growth expected for the petroleum refining industry will come primarily from strongly increasing domestic demand. Efforts to increase the Kingdom's share in the value added generated from its crude oil resources will be continued.

Petrochemicals

Adverse world market conditions prevented this sector from reaching the potential expected at the beginning of the Fifth Plan. However, a number of positive developments helped to improve performance in the last two years of the Fifth Plan. These included the increase in world demand and higher prices for petrochemical products, the lowering of barriers to Saudi petrochemical exports in some importing countries, the rapid development of new markets and higher productivity. This positive trend is expected to continue throughout the Sixth Plan period, when the petrochemical industry is projected to grow at an average annual rate of 8.3 percent.

Other Manufacturing

Together with the downstream oil and petrochemical sectors, these "other" manufacturing industries form the backbone of the industrialization drive in the Kingdom. The diversification already achieved in this sector is impressive. The 4.9 percent annual growth expected for these diverse activities will result from the active pursuit of export and import substitution opportunities, and the deepening of linkages between Saudi industries. Domestic markets, especially those for consumer goods, have now reached a volume where import substitution can realistically be targeted through the economies of large-scale industrial production. As in the previous plan period, agreements under the Peace Shield and Al Yamamah Offset Programs will also induce growth in high technology manufacturing.

Public Utilities

During the Fifth Plan period, a number of factors contributed to the rising demand for public utilities (electricity, gas and water). These included the rapidly growing urban population, the strong growth in energy-intensive production activities, and a change in consumption patterns following the further reduction of already low and highly subsidized tariffs. The wider use of demand management techniques, such as selective tariff increases, to bring user charges more into line with production costs without jeopardizing social considerations, will prevent a continuation of recent trends in water and electricity consumption into the Sixth Plan period. As a result, output growth in this sector is expected to average 5.5 percent annually.

Construction

The post-war construction boom had subsided by the end of the Fifth Plan. The demand for residential buildings is expected to increase, however, although rising prices are expected to limit this growth to less than the rate of increase in population. Commercial buildings for office space and shopping malls will be in sufficient supply during the first two years of the Sixth Plan. Because of relatively tight budgets over the Plan period, government investment in non-residential buildings and infrastructure expansion will provide a significant stimulus to the construction industry only late in the Sixth Plan period. Against this background, the construction sector is expected to grow at an average annual rate of 4.0 percent.

Trade

The decline in previously ample trade margins and the unusual circumstances that pertained at the beginning of the Fifth Plan period, negatively affected growth in the trade, hotel and restaurant sector during the Fifth Plan period. However, the increase in population and incomes during the Sixth Plan is expected to revive consumer demand for distribution, food and recreation services, which, together with a continuing high level of general business activity, will induce an annual growth rate of 6.2 percent in the trade sector.

Transport and Communications

The demand for transportation and communications services is closely linked to the level of overall economic activity. Thus, this sector is projected to grow at an average rate of 2.9 percent annually in the Sixth Plan.

Real Estate

The surge in real estate transactions immediately after the Gulf crisis abated and growth in this sector returned to more normal levels by the end of the Fifth Plan period. The real estate sector is expected to grow at an average rate of 3.3 percent annually, with most of the growth concentrated in the later years of the Sixth Plan period.

Financial and Business Services

In general, the financial, insurance and business services sector has stood the test of the crisis and war remarkably well. The degree to which individual financial institutions were able to capitalize on the post-war economic upswing differed significantly, mainly because of value adjustments necessitated by non-performing loans. These difficulties were largely resolved by the end of the Fifth Plan, so that the financial sector is expected to grow at an annual rate of 4.3 percent during the Sixth Plan period, or at about the same rate as private sector economic activity as a whole.

Community and Personal Services

Although relatively small in terms of value added, this sector accounts for a significant proportion of total employment in the Kingdom. Domestic household services are the dominant element in this sector. This sector is expected to grow at an average annual rate of 3.4 percent in the Sixth Plan period.

Government Services

Value added in the government sector is approximated by the compensation paid to government employees. With a rapidly growing population and efforts to strengthen the defense capability of the nation, employment in government services will continue its growth trend of recent years. As a result, the government sector's contribution to GDP is planned to grow at 2.7 percent annually during the Sixth Plan.

Crude Oil and Natural Gas

The OPEC members, and especially those belonging to OAPEC, are the only countries which can expand their production profitably at the moderate prices expected to prevail until the end of the Sixth Plan. Any shortfall in production arising from declining reserves in other producer countries and any increase in world oil demand arising from the worldwide economic recovery currently under way, is expected to be met primarily by OPEC oil. As a result, the crude oil and natural gas sector is projected to grow at an average annual rate of 3.8 percent during the Sixth Plan.

4.3.3 STRUCTURE OF THE ECONOMY

Over time, differential growth rates in individual sectors will change the overall structure of the economy, particularly if such differences are substantial. Because most sectoral growth rates are expected to lie within a similar range, however, the structure of the economy is expected to change only gradually during the Sixth Plan period (Table 4.3). This will remain valid except for the crude oil sector where increase in oil prices by the end of the Sixth plan would increase the contribution of this sector to GDP by about the same rate as that witnessed during the Fifth plan as a result of oil production increase.

The government's share in non-oil sectors' value added is expected to decrease slightly over the Sixth Plan (Figure 4.2), reflecting the continuing restraint on the expansion of government. The share of the service sectors will remain largely unchanged, while the producing sectors are expected to continue past trends and to increase their share by 2 percent (Table 4.3).

Figure 4.2
Structure of Non-Oil GDP (at current prices)

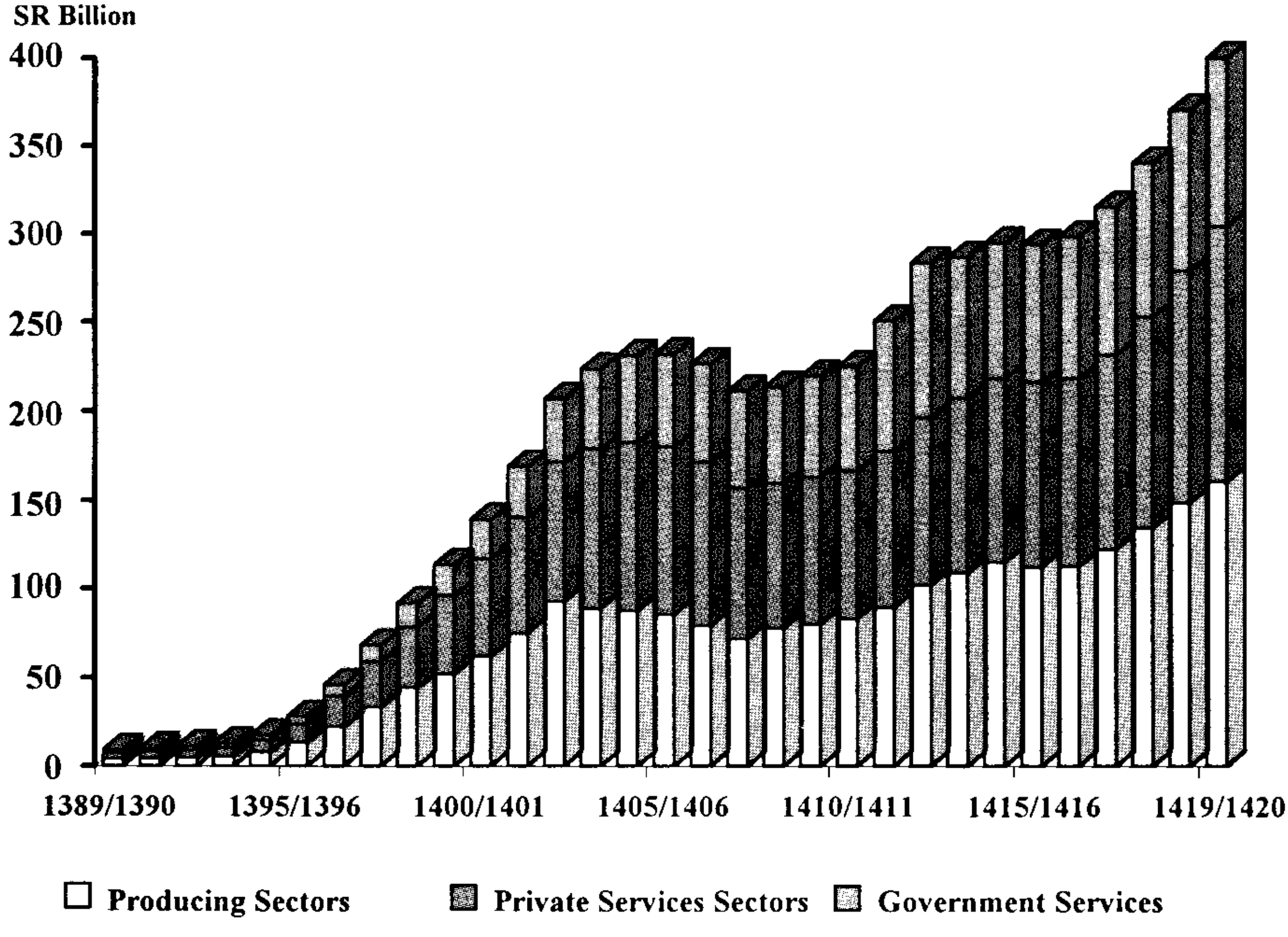


Table 4.3

Structure of the Economy in the Sixth Plan (at current prices)

Sector	Value Added (SR billion)		Share in Non-Oil Gross Domestic Product (percent)		
	1414/15	1419/20	1409/10	1414/15	1419/20
Producing Sectors	**112.2**	**160.2**	**36.9**	**38.3**	**40.2**
Agriculture, Forestry, Fishing	31.9	39.5	10.1	10.9	9.9
Other Mining, Quarrying	2.7	4.4	0.8	0.9	1.1
Manufacturing	**38.3**	**56.4**	**11.3**	**13.1**	**14.2**
- Petroleum Refining	16.4	26.1	4.2	5.6	6.6
- Petrochemicals	3.8	6.4	1.8	1.3	1.6
- Other Manufacturing	18.1	23.9	5.3	6.2	6.0
Electricity, Gas, Water	0.8	1.3	0.3	0.3	0.3
Construction	38.5	58.6	14.4	13.1	14.7
Service Sectors	**103.5**	**143.0**	**37.3**	**35.4**	**35.8**
Trade, Restaurants, Hotels	32.2	44.2	11.6	11.0	11.1
Transport, Communication	29.2	38.1	10.3	10.0	9.5
Finance, Insurance, Real Estate and Business Services	**28.3**	**40.2**	**10.3**	**9.7**	**10.1**
- Real Estate	7.9	11.4	2.7	2.7	2.9
- Other	20.4	28.8	7.6	7.0	7.2
Community, Social and Personal Services	13.8	20.5	5.1	4.7	5.1
Government Services	77.0	95.6	25.8	26.3	24.0
Non-Oil Sectors	**292.7**	**398.8**	**100.0**	**100.0**	**100.0**
Crude Oil and Natural Gas	144.7	204.5	---	---	---
Crude Oil and Natural Gas as a percentage of GDP	---	---	27.0	32.9	33.8
Other Items (1)	2.7	1.0	---	---	---
Gross Domestic Product	**440.1**	**604.3**			

(1) Import duties less imputed bank service charges.

4.3.4 GROWTH AND STRUCTURE OF EXPENDITURE ON GROSS DOMESTIC PRODUCT

Expenditure on GDP in the Sixth Plan will reflect the high priority assigned to investment. The combined gross fixed capital formation of the government, the private sector and the oil sector is targeted to grow at an average annual rate of 8.5 percent (in 1409/10 prices) during the Sixth Plan period where government investment in expected to increase at an avevage annnal rate of 19 percent and private investment at 4.9 percent (Table 4.4). This anticipated increase will reverse a decline in the rate of investment which occurred towards the end of the Fifth Plan. As shown in Table 4.5, the growth in investment will bring investment's share of GDP from 15.5 percent at the beginning of the Sixth Plan to almost 19 percent by the end of the Plan (at current prices). This is comparable to the investment rate in many other rapidly growing modern industrializing nations.

Table 4.4

Expenditure on Gross Domestic Product in the Sixth Plan (at 1409/10 prices) ★

	SR billion 1414/15	SR billion 1419/20	Average Annual Growth (percent)
Consumption	273.5	335.5	4.2
Government	96.6	126.5	5.5
Private	176.9	209.0	3.4
Gross Fixed Capital Formation	54.8	82.5	8.5
Oil Sector	4.9	3.7	(5.6)
Government Sector	13.7	32.8	19.0
Private Non-oil Sectors	36.2	46.0	4.9
Change in Stocks	(3.9)	(2.1)	---
Domestic Final Demand	324.4	415.9	5.1
Net Exports	56.4	42.7	---
Exports	184.1	229.5	4.5
Less Imports	127.7	186.8	7.9
Gross Domestic Product	380.8	458.6	3.8

★ Not comparable to expenditures in current prices;

( ) negative value

The strong recovery of government investment from its level in 1414/15, together with the opportunities and services offered by the government to the private sector, is expected to induce a 4.9 percent average annual growth in private investment, or significantly stronger growth than in the Fifth Plan period. Oil sector investment will decline at an average annual rate of 5.6 percent, due to the completion of its expansion program at the end of the Fifth Plan period.

In constant price terms, total consumption is projected to grow by 4.2 percent annually during the Sixth Plan, with private consumption growing at 3.4 percent, or about the same rate as during the Fifth Plan. Government consumption is planned to increase at a rate of 5.5 percent annually. The ongoing efforts to maintain the huge public capital stock accumulated in the development process are reflected in this higher than average increase.

The average annual growth in domestic final demand of 5.1 percent will be higher than both total and non-oil GDP growth. This surplus demand will be satisfied by strongly increasing imports, which will be induced primarily by imported investment goods.

Table 4.5

Expenditure on Gross Domestic Product in the Sixth Plan
(at current prices)

	SR billion		Share in Gross Domestic Product (percent)		
	1414/15	**1419/20**	**1409/10**	**1414/15**	**1419/20**
Consumption	311.6	428.4	81.9	70.8	70.9
Government	111.4	160.2	36.1	25.3	26.5
Private	200.2	268.2	45.8	45.5	44.4
Gross Fixed Capital Formation	67.9	113.4	19.1	15.5	18.8
Oil Sector	6.0	5.2	0.5	1.4	0.9
Government Sector	16.2	44.5	8.3	3.7	7.4
Private Non-oil Sectors	45.7	63.7	10.3	10.4	10.5
Change in Stocks	12.6	0.3	3.9	2.8	0.0
Domestic Final Demand	392.1	542.1	104.9	89.1	89.7
Net Exports	48.0	62.2	(4.9)★	10.9	10.3
Exports	180.2	285.3	38.0	40.9	47.2
Less Imports	132.2	223.1	42.9	30.0	36.9
Gross Domestic Product	440.1	604.3	100.0	100.0	100.0

★ Values brackets are negative

4.4 CAPITAL STOCK AND INVESTMENT

The strategic importance of investment for the development process and economic growth derives from its dual impact on the national economy. On the one hand, it is a powerful determinant of effective demand, while on the other hand, it has a significant influence on production capacity and the supply of goods and services.

4.4.1 CAPITAL STOCK AND REPLACEMENT REQUIREMENTS

Over the past three decades, the Kingdom has witnessed an impressive accumulation of capital stock in the form of physical infrastructure, manufacturing plants, buildings and equipment. At the same time, the capacity to utilize this fixed capital stock has increased as the Saudi labor force has grown and the skills of its workers have improved. The combined influence of these two forces has led to the rapid expansion of the economy.

The economy's capacity for continued expansion is directly related to the increase in capital stock, as new and more efficient equipment helps to raise productivity and results in the production and sale on domestic and international markets of more competitive goods in terms of both quality and price. In this respect, substantial investment in new capital assets is essential for continued economic growth.

A larger volume of private and public investment will be needed in the Sixth Plan period than during the Fifth Plan. In the private sector, new plant and equipment is needed by companies that are expanding and modernizing their production facilities to become more competitive in domestic and world markets. In the government sector, new facilities are needed to accommodate the growing needs of an expanding population. In the past, many sectors had excess capacity, but this has now been largely used up. Substantial new investment is needed to expand capacity in sectors such as electricity generation and telecommunications. At the same time, investment is needed in the maintenance and replacement of facilities that have been installed over the course of past development plans.

Although, up till now, there are no accurate estimates available, various indicators suggest that the volume of funds needed to meet the investment requirements of the public and private sectors will be very large. The Sixth Development Plan will include a program to prepare reliable estimates of future requirements, in cooperation with concerned agencies.

4.4.2 INVESTMENT REQUIREMENTS AND THE MOBILIZATION OF CAPITAL

4.4.2.1 Investment Requirements

An estimated gross investment of SR 472 billion will be required to achieve the economic growth targets set for the Sixth Plan. The investment requirements by sector are shown in Table 4.6 for selected years, while the expected sources of sectoral investment funds in the Sixth Plan are shown in Table 4.7.

Government services are expected to account for a significantly higher share of total investment in 1419/20 than in 1414/15 (Table 4.6), reflecting the emphasis on project expenditure in the Sixth Plan. The diverse range of investment expenditures included in government services is expected to have strong multiplier effects on many domestic sectors, especially other manufacturing, construction and other mining (quarrying). All of these sectors are expected to increase their annual investment substantially between 1414/15 and 1419/20.

Table 4.6

Estimates of capital Investment by Sector
(at current prices)

	Investment (SR billion)			Share in Total (percent)		
	1409/10	1414/15	1419/20	1409/10	1414/15	1419/20
Producing Sectors	**16.0**	**21.7**	**45.8**	**26.4**	**31.9**	**40.5**
Agriculture, Forestry, Fishing	1.9	2.8	3.3	3.1	4.1	2.9
Other Mining, Quarrying	0.3	0.6	1.2	0.5	0.9	1.1
Manufacturing	7.4	11.2	15.4	12.2	16.5	13.6
- Petroleum Refining	0.2	0.7	0.6	0.3	1.0	0.5
- Petrochemicals	3.4	3.3	5.5	5.6	4.9	4.9
- Other Manufacturing	3.8	7.2	9.3	6.3	10.6	8.2
Electricity, Gas and Water	4.6	4.5	22.3	7.6	6.6	19.7
Construction	1.8	2.6	3.6	3.0	3.8	3.2
Services Sectors	**14.7**	**17.0**	**21.0**	**24.4**	**25.0**	**18.5**
Trade, Restaurants, Hotels	3.1	4.7	5.9	5.1	6.9	5.2
Transport, Communications	7.3	5.9	6.7	12.1	8.7	5.9
Finance, Insurance, Real Estate and Business Services	3.3	4.9	6.4	5.5	7.2	5.6
- Real Estate	1.2	1.9	2.5	2.0	2.8	2.2
- Other	2.1	3.0	3.9	3.5	4.4	3.4
Community, Social and Personal Services	1.0	1.5	2.0	1.7	2.2	1.8
Government Services	**19.9**	**12.3**	**28.3**	**32.9**	**18.1**	**25.0**
Residential Housing	**8.4**	**11.6**	**13.7**	**14.0**	**17.2**	**11.9**
Non-oil Sectors	59.0	62.6	108.8	97.7	92.2	95.9
- Crude Oil and Natural Gas	1.4	5.3	4.6	2.3	7.8	4.1
Total Investments	60.4	67.9	113.4	100.0	100.0	100.0

Investment in the producing sectors in 1419/20 is expected to be 186 percent higher than one decade earlier, while investment in the services sectors is expected to be 43 percent higher. The faster increase expected for investment in production activities is an encouraging sign for the progress of diversification and the further strengthening of the Kingdom's economic base. A significant contribution to these efforts is expected from the "other manufacturing" sector, which encompasses a wide variety of production activities. The anticipated increase in annual investment to SR 9.3 billion in this sector by the end of the Sixth Plan confirms the success of the government policy to provide well developed facilities in the industrial cities, together with financial support and other incentives to manufacturing establishments.

Investment requirements for residential housing will continue to increase, reflecting the needs of a growing population and the rising cost per housing unit in the metropolitan areas. With its strong links to construction, other mining and other manufacturing sectors, investment in housing will generate demand in these related sectors and encourage investment in their expansion.

Funding of investment in the Sixth Plan will be provided by several sources (Table 4.7).

Estimates of capital investments in the main economic sectors is shown in Figure 4.3

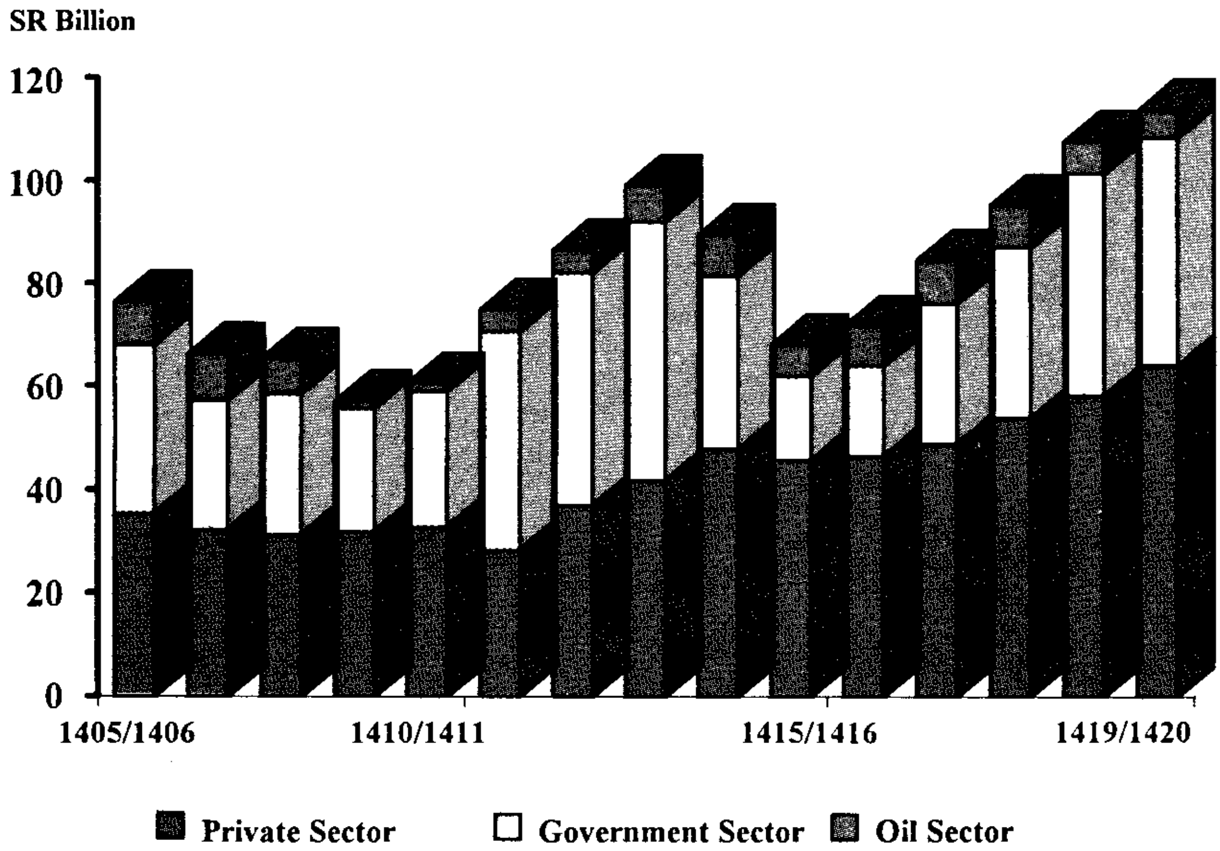
Table 4.7

Estimates of Sixth Plan Investment Financing Requirements by Sector and Source (SR billion at current prices)

Sector	Total Sixth Plan	Private Sector	Public Sector★
Producing Sectors	**181.0**	**88.9**	**92.1**
Agriculture, Forestry, Fishing	14.6	10.0	4.6
Other Mining, Quarrying	4.1	2.2	1.9
Manufacturing	64.7	31.8	32.9
Petroleum Refining	4.2	2.1	2.1
Petrochemicals	22.2	2.8	19.4
Other Manufacturing	38.3	26.9	11.4
Electricity, Water	83.1	31.5	51.6
Construction	14.5	13.4	1.1
Service Sectors	**92.0**	**76.8**	**15.2**
Trade, Restaurants, Hotels	24.6	24.4	0.2
Transport, Communications	32.9	21.9	11.0
Finance, Insurance, Real Estate and Business Services	26.2	23.3	2.9
Real Estate	10.3	8.2	2.1
Financial and Business Services	15.9	15.1	0.8
Community, Social and Personal Services	8.3	7.2	1.1
Government Services	103.4	0.0	103.4
Residential Housing	64.1	47.0	17.1
Non-Oil Sectors	**440.5**	**212.7**	**227.8**
Crude Oil and Natural Gas	31.5	0.0	31.5
Total Investment	**472.0**	**212.7**	**259.3**

★ Government agencies, specialized funds and public companies.

Figure 4.3
Fixed Capital Formation by Main Sector (at current prices)



4.4.2.2 Mobilization of Capital

Profitabillity is the key to the successful mobilization of private capital for domestic investment in fixed assets. Private capital has to be attracted to domestic investment in a market-oriented economic system where investment decisions by private investors are determined by perceived risk/return relations of investment opportunities worldwide.

The contribution of the private sector is essential for the achievement of the Sixth Plan investment objectives. The mobilization of private capital will require a regulatory framework enabling financial intermediaries effectively to perform their allocative functions of collecting funds from private households and enterprises with financial surpluses by offering attractive returns and transferring these funds to sectors offering profitable investment opportunities.

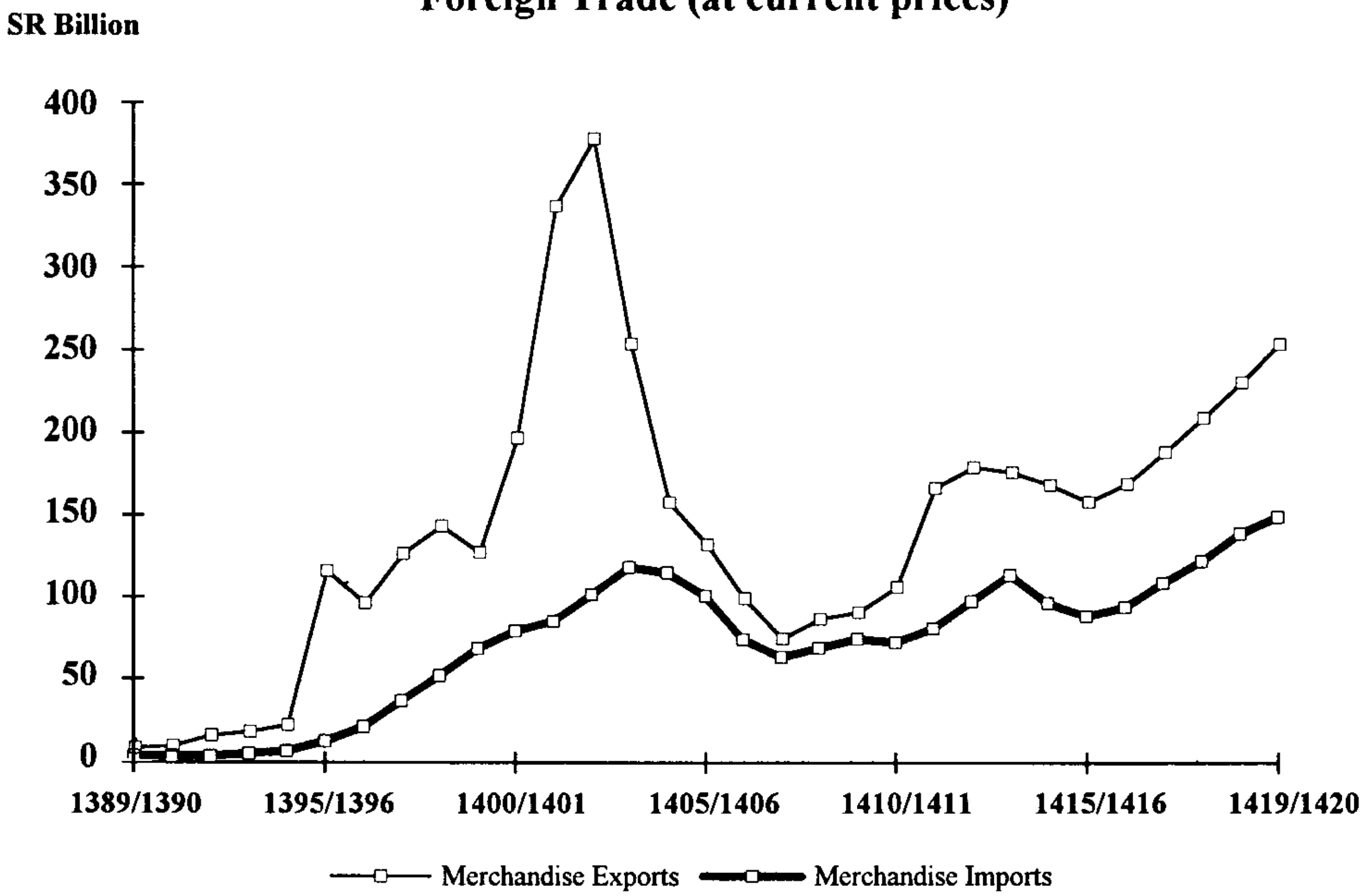
To claim a higher share of domestic savings for the financing of investment in fixed assets or to attract foreign capital into the Kingdom will require a wider range of short-and long-term financial instruments. With a more developed and competitive capital market, the transformation of short-term financial assets into long-term capital and the reduction/sharing of risks will be possible. An innovative capital market could provide private sector companies with an attractive and significant complement to the government's specialized credit institutions as a source of non-equity finance for long-term investment.

Other institutional innovations could also contribute to the mobilization of capital by channeling a large share of private savings to investment through various investment vehicles and channels. Licensing for these and similar institutions will be considered as a Sixth Plan policy option.

4.5 FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Foreign trade is vital to the process of economic development in the Kingdom, as it represents a dual link between the domestic and international economies, in terms of both the physical and financial flows related to the exports and imports of goods and services. As a percentage of GDP, exports now reach about 40 percent, while imports as a percentage of non-oil GDP stand at about 45 percent. Furthermore, the significance of foreign trade to the Kingdom is evident by the fact that Saudi Arabia is the world's largest oil exporter and ranks 20th in the world in terms of foreign trade volume. Figure 4.4 shows development in the Kingdom's foreign trade over the previous five development plans.

Figure 4.4
Foreign Trade (at current prices)



4.5.1 FOREIGN TRADE AND BALANCE OF PAYMENTS OBJECTIVES

Within the framework of the medium and long-term development strategy, the government of the Kingdom aims to achieve the following objectives:

(1) Making radical changes in the structure of the balance of payments and protecting the national economy growth path against adverse external impacts;

(2) Re-building the Kingdom's foreign reserves and maintaining the value of the national currency;

(3) Increasing the Kingdom's share of the international market for oil and petrochemical products, commensurate with its share of the world's crude oil reserves;

(4) Increasing non-oil exports as a proportion of total exports;

(5) Expanding international economic and trade relations, and in particular, enhancing regional cooperation with GCC states and other Arab and Islamic countries.

4.5.2 OPPORTUNITIES AVAILABLE IN THE WORLD ECONOMY

World trading patterns are changing due to the formation and growth of trading blocs, such as the European Union (EU) and the North American Free Trade Area (NAFTA), as well as to different levels of economic development and growth rates between countries. At the end of the Fifth Plan period, the economies of the European Union had not yet begun to recover strongly from recession, while the longer term structural adjustment problems facing Eastern Europe and the newly independent countries of the former Soviet Union will continue to limit their demand for imported goods for some time. In contrast, the North American economy had already begun to recover from recession, while some of the Far Eastern economies, such as Hong Kong, Taiwan, and Malaysia, continued their rapid growth of recent years.

Export opportunities for the Kingdom in the Sixth Plan period are likely to shift away from Europe and North America in favor of the GCC and the faster growing Asian economies, whose trade is expected to grow by around 9 percent annually, or at twice the growth rate of North American or European trade. India, and especially China, will provide substantial opportunities for increased trade as their markets open up, while Japan and South Korea can also be expected to offer increasing opportunities for Saudi exporters, as their economies recover and their trade policies are gradually liberalized. Nearer to the Kingdom, the GCC is expected to be one of the fastest growing trade areas in world.

The Kingdom's decision to join the GATT will pave the way for new opportunities for the Kingdom's petrochemicals exports, as customs duties will be reduced in the 125 signatory countries to within the range of 5.5 percent and 6.5 percent from the beginning of 1995. It is generally expected that the trade liberalization measures agreed in the Uruguay Round will continue to have positive impacts on the volume of world trade, which is expected to grow by between $ 200 billion and $ 300 billion as a result.

4.5.3 CONSTRAINTS ON FOREIGN TRADE GROWTH AND DIVERSIFICATION

Notwithstanding the growing positive trends in the world economy in general, and the more favorable conditions for expanding the Kingdom's foreign trade, however, the achievement of the above-mentioned foreign trade objectives faces real constraints at both international and domestic levels. At the international level, the Kingdom's foreign trade faces the following structural constraints:

Persisting Protectionism in the industrialized Countries :

Despite the progress achieved in trade liberalization following the conclusion of the Uruguay Round, trade in crude oil is still not included under the regulations of the new GATT accord, thus making it subject to continued tariff and non-tariff barriers imposed by the industrialized countries, which discriminate against oil in favor of other energy sources. Taxes on oil products in some countries are up to four times the revenues per barrel of oil received by the oil exporting countries.

Moreover, plans are being formulated in these countries to raise the tax burden on petroleum products still further, through the introduction of new types of tax, such as carbon or energy taxes. Clearly, the imposition of these additional taxes will exert further downward pressure on future world demand for oil, thereby reducing the income of oil exporters, limiting their development potential and reducing their role in the global economy.

Growing Role of Regional Economic Blocs

Undoubtedly, regional economic blocks are of significant benefit to participant countries, as evidenced by the dedicated efforts of the industrial countries in this direction. Three such regional blocks are the EU, NAFTA and APEC (Asia Pacific Economic Cooperation), which together have a major influence on the world economy and on international trade flows. The formation of such economic blocks hinders the endeavors of GATT to promote pluralism and transparency in international markets. Under such developments, the Kingdom's exports are expected to face sharp competition in world markets, as world trade flows are diverted in favor of trade within the major regional groups.

The Kingdom's Terms of Trade

The Kingdom's terms of trade showed a steady decline over the period 1400 to 1411, as the index number of the ratio of export prices to import prices fell from 100 to 50 according to UN data. Thus, the purchasing power of the Kingdom's exports fell by half during this period, as import prices rose by 32 percent while export prices declined by 65 percent. Notwithstanding the relative improvement in export prices in 1410 and 1411, the subsequent decline in crude oil prices and the value of the U.S. dollar in the later years of the Fifth Plan period led to a further deterioration in the Kingdom's terms of trade in favor of the oil importing countries.

At the *domestic* level, intensive efforts are needed in the following areas to boost the development and diversification of non-oil exports:

Institutional Framework

Notwithstanding the achievements made by the Export Development Center at the Council of Saudi Chambers of Commerce and Industry, a continuing effort is needed to diversify and expand the scope of its activities and services. At the same time, the commercial banks have been reluctant to extend export financing facilities to exporters in the case of countries where payments can be delayed. In overcoming these difficulties, small and medium-sized exporters need the support of an export credit guarantee institution.

Furthermore, increased coordination between export related government agencies and the private sector will further enhance and develop private sector exports

Export Marketing Skills

Exporting success requires the availability of certain skills, such as establishing and maintaining contacts in foreign markets, foreign language skills, and the ability to deal effectively with banks, insurance and shipping companies, foreign agents and clients. The small and medium - sized enterprises are expected to intensify efforts towards the employment of qualified saudi staff in the fields of production and marketing. In this respect, the efforts of the Saudi Company for Industrial Exports (established in 1411) have been substantial and will become even more significant for the marketing of non-oil exports during the Sixth Plan period. The sales of this company, which reached SR 200 million in 1413/14, are expected to grow steadily in the future.

Information for Exporters:

Broad structural shifts and rapid changes in the geographical pattern of world trade have led to intense competition between exporters. Entry into foreign markets, or even maintaining existing positions in these markets, is becoming increasingly difficult, unless the exporter acquires a thorough understanding about consumer needs and the overall supply and demand conditions in these markets.

The Ministry of Industry and Electricity and the Chambers of Commerce and Industry have been making great efforts to provide information and data about domestically manufactured products. However, such information is not sufficient for exporters because no comparisons are made between the advantages and disadvantages of national and foreign products, which might enable exporting opportunities to be reliably assessed.

4.5.4 FOREIGN TRADE POLICIES

Government policies related to foreign trade and the balance of payments concentrate on the following strategic principles:

First: Optimizing the contribution of foreign trade to the development process and boosting its role in meeting the Kingdom's financial, physical and technological needs, by maximizing export revenues, while minimizing the outflow of physical and financial resources and guarding against their potential depletion.

Second: Continue to develop the institutional framework of foreign trade, to upgrade the organizational capabilities of relevant public and private establishments, and to improve coordination between these establishments.

The following are the most important policies the government will continue to implement:

- Ensuring the continuity of monetary policy and maintaining the value of the national currency;
- Supporting export-oriented industries that use locally available resources, particularly the petrochemical industries, oil refineries and other energy-intensive industries;
- Developing a system of incentives for non-oil exporting industries similar to the existing system of incentives for import substitution industries;
- Enhancing the efficiency of the system of customs tariffs on imports in collaboration with GCC states and in conformity with GATT rules;
- Intensifying efforts to establish a national institution entrusted with export financing and export credit guarantee functions;
- Supporting the Exports Development Center at the Saudi Council of Chambers of Commerce and Industry, as well as its initiatives for the establishment of a national information system about international trade and world markets;
- Improving coordination between the Kingdom's aid to developing countries and its foreign trade objectives, as well as expanding export loans on easy terms and credit guarantees to friendly countries;
- Boosting regional trade cooperation with GCC states, the unification of customs systems, standards and specifications, as well as the expansion of joint ventures;
- Expanding economic and trade cooperation with other countries through establishing more bilateral and multi-lateral agreements, particularly with Arab and Islamic states.

4.5.5 GROWTH Targets

The following quantitative objectives for the growth of Foreign trade and the structure of the balace of payments have been identified in the light of the Sixth Plan forecasts for the development of the overall economy :-

- Gradual reduction of the current account deficit in the balance of payments over the Sixth Plan period;
- Average annual growth in non-oil export revenues of around 12 percent over the Sixth Plan period.