The Policy of Diversification

After discussing the economic structure of Saudi economy, and the role and implication of a large oil sector in Chapter-2, a study is undertaken about Saudi Arabia's general economic policy. Since Saudi Arabia's oil reserves are the largest components of the wealth or assets, hence sound oil policy is of prime importance. The essential feature of a rational oil policy would have as its prime objectives, maximization of oil revenues. For this the Saudi government has to evolve strategies. It was also advised that Saudi Arabia should invest a large portion of its current NNP or oil revenues in areas yielding a high real return to compensate for depletion of oil.¹ The real return does not mean an artificial return and does not incorporate explicit and implicit subsidies like low energy prices, over valued exchange rate and tariffs. For compensating depletion of oil it is not necessary that investment should be domestic only. In Saudi Arabia oil revenues accrue to the government. It places more responsibility on the government to pursue sound economic and investment policies. The long term official

¹ Hossein Askari, *Saudi Arabia's Economy: Oil and the search for Economic Development*, Department of Business Administration, George Washington University, p.25
objectives of Saudi Arabian government policy since the 1970’s have been to diversify the economy. And to reduce the kingdom’s dependence on oil revenues, development of infrastructure, maintaining stable prices and promoting sufficient economic growth to ensure the satisfactory employment opportunities for all.²

Since the 1970’s there were major changes in the economy, including some degree of diversification, the economic situation changed dramatically and oil exports expanded substantially. Royal payment and taxes on foreign oil companies increased sharply. Oil exporting countries including the kingdom of Saudi Arabia began setting and raising oil export prices. Saudi Arabia’s revenues per barrel of oil quadrupled from US$ 0.22 in 1948 to US$ 0.98 in 1970.³ By 1973, the price had reached US$ 1.56 and soared to US$ 10 and further higher in 1974, following the Arab oil embargo introduced to pressurise the Western Backers of Israel during the October 1973 war.

In 1982 the average export prices per barrel of oil reached well above US$ 30.⁴ Between 1970 and 1980, Saudi oil revenues jumped from US$ 4.3 billion to US$ 101.8 billion. The higher oil revenue inflow provided Saudi authorities the leverage to make the major structural changes in the economy. High growth in oil revenues inflow

⁴ Ibid.
was utilized to build impressive infrastructure with good highways, ports and airports and considerable investments in telecommunication, electricity industries or urban services. Within Saudi Arabia, there has been a section apprehensive about the rapid economic transformation. While some others mainly from the technocratic elite, were concerned about the economic consequences of such a rapid expansion in expenditure. One choice facing policy makers in the early 1970’s was whether to restrict oil production to a level that was adequate to finance limited economic and social development. The other choice was to allow production at a level that would meet world demand for crude oil. Choosing a relatively high production level would force a decision on whether to use resulting revenues for rapid domestic economic and social development or long term investment abroad. There were other policy choices. An alternative strategy to keep oil in the ground, except for the needed for limited development was advanced strongly. It was argued that this policy would best preserve the countries resources for future generations. But decision making process was not always transparent. Only one policy seemed to be adopted. That the domestic economic policy did not drive oil production and export policies. Faisal Ibn Abd Al-Aziz Al-Saud promised to keep oil flowing at moderate prices (reasonable), commensurate (corresponding or proportion) with

world demand, arguing that the kingdom was dependent on the stability and prosperity of consuming nations. As those nations were dependent on Saudi oil. Moreover, moderate prices were essential if Saudi Arabia wanted to ensure that oil would remain the energy source of choice.

By the mid 1970's the Saudi government had decided to use most of the growing oil revenues for massive development effort. Industrialization has been the important part of this effort. It was done largely by investing in processing plants that used the country's hydrocarbon resources. This policy meant at least a decade of very large investment to build the plants and the necessary infrastructure. It meant financing and building the gas-gathering system, the pipe line for gas and crude oil to bring the raw material to the two main industrial sites i.e. Jubail & Yanbu. The development efforts also included many other projects such as the huge and costly airports at Riyadh and Jeddah, hospitals, schools, industries and plants, roads and ports. By the mid 1980's the total massive expenditure on the infrastructure was US$ 500 billion.

The Saudi Arabia's decision to utilize the country's oil and gas revenues develop downstream sectors like refineries and petrochemicals plants was logical considering the countries' resource endowment.

There were three factors which motivated such a strategy.

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1. Down stream investments were capital intensive which fitted Saudi Arabia’s small population and large oil revenues.

2. More value-added income would be extracted and retained, thereby maximizing Saudi revenues through the export of more refined products instead of crude oil. Thus the natural gas that had been largely wasted before the 1980’s was to be processed and used.

3. Some Saudi planners saw industrialization as another opportunity to widen the sphere of economic activity for foreign and domestic private firms. Saudi Arabia invited so many industrial oil companies to invest in joint venture in new export refineries built in the kingdom during the late 1970’s and early 1980’s. At that time there was very urgent need for technology. So, participation of international oil companies was considered necessary. Because international companies were having more advanced and state of the art technologies than Saudi company.

To promote private sector’s investment and to support future consumption large funds were spent on development program in Saudi Arabia. Starting in the mid 1970’s the government of Saudi Arabia decided that an adequate infrastructure was essential for future development. This infrastructure included the renovation and building of

10. SAMA Annual Report, 1975
electricity, water, sewerage, and telecommunication systems. In terms of generating and distributing electric power, the government of Saudi Arabia assisted private companies building and operating its electricity network through concessionary capital loans and continuing operating subsidies. Under King Faisal Ibn Abd Al Aziz Al Saud (1964-75) there was a massive increase in government's spending on education to an annual level of about 10 percent of the budget. The Saudi planners also realized the need for a subsidy programme to supplement direct government outlays. The major reason was income distribution. Waiting for the oil expenditure to reach these economic and social objectives might have generated social tension. Therefore, the government adopted a widespread subsidy programme for utilities, fuels, agriculture, social services (both private and public), the industrial sector and several other areas. Beyond income distribution, the rational of subsidy programme was the need to promote non-oil development through cheap loans, technical assistance, industrial and agriculture initiatives, and preferential buying of domestic product by the government.

Thus it seems that the strategies from the period of rapid development of the mid 1970's to the early 1980's stemmed from the

13. *Middle East Economic Survey*, 40(42); 20 Oct, 97, D.1-D.6
government willingness to subsidize production, consumption and investment. The objectives for subsidization were three fold.

1. Encouraging non-oil economic activity.
2. Meeting social goals.
3. Distributing income.

**Economic Diversification Policy After the 1986 Oil Price Crash:**

The general thrust of Saudi economic policy underwent a fundamental change after the oil price crash of 1986. The serious depletion of foreign assets, combined with the extensive decline in oil revenues, necessitated a revised economic policy. The depreciation of the United States dollar in international financial markets also hurt Saudi purchasing power abroad. Reappraisal of the development programme became necessary. The most urgent task was shoring up government finances. Domestic constraint allowed only a few options, especially in terms of raising non-oil revenue.

The Saudi high dependency on oil export as a major source of income and exchange earning resulted in a series of external shocks during the mid 1980's, when the price of oil fell below ten dollars per barrel in 1985.\(^{14}\) This caused the country to experience a severe reduction of foreign exchange reserves on which infrastructural
development and production depended. As a result the growth rate of the economy slowed down since then the chief concern among the Saudi Arabia planners and policy makers has been: 'what will happen when the oil runs out or the world no longer requires it'? Therefore, recent development plans have focused on economic diversification as a strategy to increase the production capability of non-oil sectors.

**Direction of Major Economic Policies:**

1. Underpinned by the world's largest crude oil reserves (accounting for 25% of world's total reserves), Saudi Arabia has not only pursued a stable long term economic growth, but also implemented policy of diversification into non-oil sectors, privatization programme, building Saudi human resource base and efforts at attraction of foreign investment.

2. With an aim to prepare for the era of depleted petroleum resources and to transform the economic structure which depends on the fluctuating international oil price, Saudi Arabia has been strongly pushing ahead with the industrial diversification policy.

3. For some periods Saudi Arabia had been able to reduce the share of oil revenue in the nation's Gross Domestic Product (GDP) by actively nurturing the petrochemical industry and
non-oil sectors such as agriculture, manufacturing and merchandising.

Policy of Economic Diversification in 1990’s:

The government’s attempt to deal with chronic (record) budget deficits, largely through expenditure retrenchment (reduced cost), depletion of foreign assets and the sale of development bonds generally helped stabilize its financial position by the late 1980’s. During 1989 and 1990, economic planners had renewed optimism. New plans were made to put the oil and non-oil sectors of the economy on fast track. The perceived recovery in international oil consumption and prices provided regional policy makers the opportunity to resume spending and promote economic growth. As a result, two major initiatives became the basis of Saudi economic policy.

1. Saudi Arabia unveiled plan to raise crude oil production capacity to between 10.5 million and 11 million bpd by 1995. The restructuring of the General Petroleum and Mineral Organisation (Petromin), gave it control over various Kingdom’s oil refineries. This had been a comprehensive effort to promote investment in oil sector. Yet another indication of Riyadh’s intentions came in 1989, when Saudi Aramco

15 . Ibid.
purchased 50% of Star Enterprises in the United States. A joint venture with Texaco that indicated Saudi Arabia’s pursuit of geographically diversified downstream projects.

2. The government was not eager to continue its increase in fiscal expenditures, despite moderately higher oil prices. Military outlays, oil capacity, expansion plans, and current expenditure accounted for the bulk of total spending and did not permit a fiscal boost. However, the non-oil private sector remained fully dependent on government spending. The sharp cutbacks in capital outlays hindered economic diversification. In light of this failure government of Saudi Arabia adopted the above two policies to reorient and revive the private sector.\textsuperscript{17}

Oil continued to dominate the Saudi economy accounting for three quarters for government revenues, and 90% of export earnings. This forced the government to focus almost exclusively upon the hydrocarbon sector, to the detriment of the rest of the economy.\textsuperscript{18} Moreover, the government and investment culture favoured the activities of huge corporation, rather than encouraging the growth of enterprise within the country. Despite this, the government forecasted that the budget deficit was to double from $6 billion in 2001 to $12 billion in

\textsuperscript{17} Ibid.
\textsuperscript{18} Hossein Askari, \textit{Saudi Arabia’s Economy: Oil and the search for Economic Development}, Department of Business Administration, George Washington University, 1990, p.27
2002, with expenditure set at 202 billion riyals and revenues estimated at 157 billion riyals. This would match the 1998 deficit when the oil prices averaged just over $12 a barrel.\textsuperscript{19} This indicates that a growing budget deficit has been a catalyst in forcing the government to pursue its diversification policies. The chief economist at the National Commercial Bank, Said Al Shaikh said “I believe that pressure on reforms will build up, and the pace of privatization will be faster.”\textsuperscript{20} The Saudi economy continued to make notable progress during 2002. The Gross Domestic Product maintained its uptrend. The current account of balance of payment was in surplus for the fourth consecutive year. The domestic price situation continued to be characterized by market stability. Money supply expanded at an accelerated rate along with a high growth rate in the non-oil private sector. The banking sector witnessed continuous progress and maintaining high efficiency rates in international standard. Therefore, the privatization process and economic restructuring of several areas of economic and social activities continued during the above period.\textsuperscript{21} Since the 1970’s Saudi Arabia’s economy has observed notable changes through diversification policy. The government in Saudi Arabia, has been successful in maintaining the stable macro economic conditions. Which is regarded by many as crucial for any take off into

\textsuperscript{19} SAMA Annual Report, 1999, p.42
\textsuperscript{20} Pike, David, MEED, Special Report, Saudi Arabia, 22 March 1991, pp.16 & 17
\textsuperscript{21} Saudi Arabia: Seventh Five Year Plan (2000-2005), MEES, 43(41), 9 Oct 2000, pp. D.1-D.7
self sustaining development. The price stability has been prime objective of government economic policy. The average rate of inflation over the period 1990-96 was only 2.1% annually. Since then there has been price stability with falls of 0.6% in 1998 and 1.3% in 1999, and a rise of 1.2% in 2000, and 3.5% in 2003.  

But it would be naïve to conclude that government policy has failed because Saudi Arabia's economy has not diversified sufficiently away from oil dependence or achieved self-sustaining growth. Significant achievement has taken place during the period covering the seven five years plans introduced and implemented since 1970, most notably the provision of infrastructure and urban growth. Macro economic activity has been largely achieved with low inflation. Government finance has been less satisfactory, and working of the real economy have proved disappointing with unimpressive private sector performance. Nevertheless, the Kingdom's economy has been modernized and the quality of some services such as banking and finance has become as good as in many western countries. Although provisions for educational facilities could be improved, but has still been reasonably good by regional standard. Despite these achievements, government policy has failed to ensure that the supply side of the domestic economy responds adequately to the demand for an ever

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increasing population. The demographic pressure in the market can turn to advantage if domestic market expansion becomes the major engine of growth as opposed to simply oil. There are two aspects which indicate that objective of diversification was not fully realized. Both of these relate to the need to make provision for the period when oil production would begin to decline.

1. The country requires substantial holding of foreign assets to provide a long term investment income constituting a buffer for the period when income from oil production declines. The reserves held at the end of 2004 were lower than they were in the second half of the 1970’s and through the 1980’s. They reached the peak of $120 billion in the earlier period, declining substantially during the first Gulf War, and standing in 2004 at approximately $68 billion. Although the latter figure is substantially greater than the $30 billion to which reserves sank in the mid 1990’s. There has been no sustained efforts towards developing a “fund for future generation” capable of supporting development in the post oil era. At the end of 2004, it was estimated that private Saudi sources held at least $650 billion in investment outside of the country.

24. Ibid.
2. Despite governmental attempts to diversify the economy, progress made has been inadequate. The oil sector remains dominant, just as it was in the mid 1970's. Oil and oil derivatives account for 90-95 percent of export earnings and constitutes 75 percent of budget revenues, 35-40 percent of Gross Domestic Product (GDP). One effect of this had been a decline in per capita income, the expansion of GDP did not keep pace with population growth. Per capita income reached a peak of $28,600 in 1981, but in 2004 stood at about $9,000.\textsuperscript{25} The centrality of hydrocarbon based exports, besides putting in doubt the economy's long-term viability implies a lack of employment opportunities as it is capital intensive. A significant part of oil revenues is being used to employ Saudis in the public sector. Diversification of the economy would also help to limit the economic downturn in times of weak global oil prices.

However, to further understand the policy of diversification in Saudi Arabia economy, it would be useful to study the structural dependency of Saudi Arabia economy. This is performed by analyzing the structure of Gross Domestic Product (GDP) for a few selected years.

\textsuperscript{25} SAMA Annual Report, 2005, p.56
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<td>2012</td>
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<td>19511</td>
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<td>5. Less: Imputed Bank Service</td>
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Gross Domestic Products at Constant Price (Million Riyals) by Various Sectors
Table – 2

% Share of Different Sectors in GDP

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<td>43.81</td>
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<td>46.95</td>
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Table – 3

Share of Oil in Total Trade & Gross Domestic Products in Saudi Arabia (Million Rivals)

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<tr>
<th>Year</th>
<th>Total Trade in Million Reyal</th>
<th>Oil in Total trade (Percent)</th>
<th>Oil in GDP (Percent)</th>
<th>Trade in GDP (Percent)</th>
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<td>50.4963</td>
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<td>1975</td>
<td>119235</td>
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<td>64.27</td>
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<td>1980</td>
<td>463235</td>
<td>68.92</td>
<td>62.79</td>
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<td>1985</td>
<td>185100</td>
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<td>1990</td>
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<td>1995</td>
<td>292590</td>
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<td>2001</td>
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<td>392829</td>
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<td>61.27</td>
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Source: 1. Organisation of Arab Petroleum Exporting Countries, The Secretary General’s 32nd Annual Report 2005
2. SAMA, Forty-third Annual Report 2007, Research and Statistics Department, Kingdom of Saudi Arabia
3. IMF, Direction of Trade Statistics, Year Book, 2006
Share of Oil in Total Trade & Gross Domestic Products in Saudi Arabia (Million Riyals)
Table 1 gives the data about Gross Domestic Product (GDP) at constant prices by various sectors whereas Table 2 shows percentage share of different sectors i.e. Primary Sector, Secondary Sector and Tertiary Sector in Gross Domestic Products of Saudi Arabia. For this selected years of the period of 1971 to 2006 has been taken. In the initial period the primary sector had the largest share in the Gross Domestic Product and the secondary sector had the least share in the GDP. The tertiary sector was second most important contributor to the GDP in terms of percentage share. The share of primary sector, secondary sector and Tertiary sector to the Gross Domestic Product were 64.95 percent, 11.81 percent and 23.24 percent respectively in 1971.

The importance of primary sector in terms of percentage in Gross Domestic Product declined continuously during 1971 to 2006. The share of primary sector in Gross Domestic Product was 64.95% in 1971 which declined to 33.03 percent in 2006. The share of secondary sector has marginally increased from 11.81 percent in 1971 to 20 percent in 2006. Throughout the period from 1971 to 2006 the share of secondary sector in the Gross Domestic Product was the least. The tertiary sector has increasingly become important contributor to the Gross Domestic Product. Its share rose sharply during the one and half decades between 1971 and 1986. Its share in Gross Domestic Product was only 23.24 percent in 1971 which rose to 51.71 percent in 1986.
The share of tertiary sector has more than doubled during the period 1971-1986. But its share in Gross Domestic Product exhibited a declining trend since 1991 to 2006. The share of tertiary sector was 51.71 percent in 1986 which decreased to 46.95 percent in 2006. But tertiary sector is still the largest contributor to Gross Domestic Product. The tertiary sector has emerged the largest sector to contribute to Saudi GDP.

From table 3 share of oil in total trade and Gross Domestic Product (GDP) of Saudi Arabia is found. It shows that the total trade of Saudi Arabia in 1970 was 14,104 million Riyals, the share of oil in this trade was 50.4963 percent. The contribution of oil in total DGP was 46.63% and the share of trade in total Gross Domestic Product (GDP) was 63.3 percent. In the year 1975 the total trade of Saudi Arabia has increased to 119,235 million Riyals, the share of oil in total trade was 78.40 percent. The share of oil in total Gross Domestic Product (GDP) was 64.27 percent and the contribution of trade in Gross Domestic Product (GDP) was 73.09 percent in that year. The total trade has increased to 463,235 million Riyals in the year 1980. The share of oil in total trade was 68.94 percent and the share of oil in Gross Domestic Product (GDP) was 62.79 percent and the share of trade in Gross Domestic Product (GDP) was 85.14 percent in that year. The total trade had decreased to 185,100 million Riyals in the year 1985. The share of
oil in total trade was 47.77 percent & the share of oil in Gross Domestic Product (GDP) was 28.64 percent and the trade contributed to the Gross Domestic Product (GDP) equal to 49.7 percent in that year. The total trade has again increased in the year 1990 amounting to 256,621 million Riyals in which the share of oil was 49.97 percent and the share of oil in Gross Domestic Product (GDP) was 36.87 percent and the contribution of trade in Gross Domestic Product (GDP) was 59.63 percent. The total trade has slightly increased amounting to 292,590 million Riyals in the year 1995 in which the share of oil was 36.13 percent. The share of oil in Gross Domestic Product (GDP) was 35.68 percent and the contribution of trade in Gross Domestic Product (GDP) was 55.62 percent. The total trade has again increased to 403,793 million Riyals in the year 2000. The share of oil in it was 53.10 percent. The share of oil in Gross Domestic Product (GDP) was 41.48 percent & contribution of trade in Gross Domestic Product (GDP) was 57.93 percent. The total trade slightly decreased to 371,829 million Riyals in the year 2001 in which the share of oil was 49.46 percent. The total share of oil in Gross Domestic Product (GDP) was 37.62 percent & contribution of trade in Gross Domestic Product (GDP) was 54.74 percent. The total trade again slightly increased to 392,829 million Riyals in 2002 in which the share of oil was 42.28 percent & the share of oil in Gross Domestic Product (GDP) was 37.66 percent and the share of trade in Gross Domestic
Product (GDP) was 56.14 percent. The total trade has increased to 488,099 million Riyals in 2003 in which the share of oil was 47.32 percent and the share of oil in Gross Domestic Product (GDP) was 41.47 percent and the share of trade in Gross Domestic Product (GDP) was 61.27 percent. The total trade increased to 640,284 million Riyals in 2004 in which the share of oil was 51.53 percent and the share of oil in Gross Domestic Product (GDP) was 45.60 percent and the share of trade in Gross Domestic Product (GDP) was 68.85 percent. The total trade has increased to 900,129 million Riyals in 2005 in which the share of oil was 56.05 percent, the share of oil in Gross Domestic Product (GDP) was 52.73 percent and the share of trade in Gross Domestic Product (GDP) was 76.77 percent. The total trade further increased to 1,035,045 million Riyals in 2006 in which the share of oil was 58.40 percent and the share of oil in Gross Domestic Product (GDP) was 54.58 percent and the share of trade in Gross Domestic Product (GDP) was 79.83 percent. It shows that the share of oil in total trade and the share of oil in Gross Domestic Product (GDP) has been more or less stable in this period but when we see the share of trade in Gross Domestic Product (GDP), the trade has higher share in Gross Domestic Product (GDP) in the initial year upto 1980, after that its share has declined and in the later years specially after 2003 the share of trade in GDP has risen again.
It is found that total trade of oil has increased in the period from 1970 to 2006. The share of oil in total trade in the period has been fluctuating around 50 percent. The share of oil in Gross Domestic Product has been more around 50 percent in the initial period and in the last period. This share has been low in the middle period at around 35 percent. In the same way the share of trade in GDP has been high in the initial and last periods, about 60 to 70 percent and it has been low in the middle period at about 55 percent. We observe that in the year 1970 the trade was 14,104 million Riyals. It increased to 119,235 million Riyals in 1975. It has further increased to 463,235 million Riyals in 1980. However, it decreased in 1995 and 2001 also. But after that increasing continuously reached to 1035045 million Riyals in 2006.

Economic Diversification in Five Year Plans:

By the 1960s, Saudi Arabia had made major advances in many areas. Road were established, a modern education system introduced, health care improved, agriculture expanded and factories built. Although the economy largely depended on oil revenues, Saudi authorities resolved to bring about basic improvement in the country’s economic structure. The objective was to diversify the economy away from oil into other fields. Achievement of such an economic transformation required deliberate planning and careful implementation of a development
program with clearly defined objectives. In spite of the oil boom of 1973 and formation of Central Planning Organization (C.P.O.) in 1965, Saudi Arabia follows economic development plans in order to achieve diversification and growth. The first development plant was introduced in 1970. Thus began a series of five year plans that continues till today. This planning process has proved to be crucial in Saudi Arabia's rapid and ongoing economic development.

First Five Year Plan

The first five year development plan (1970-74) was introduced in 1970. The first phase of this process involved establishing an infrastructure that could support a modern economic base. It included the guidelines for systematic action in every field of the Saudi economy. Being planned in a time of financial shortage, the plan could not predict the revolution in the oil market, which was to take place since 1973. The price of light oil jumped from $1.80 per barrel in 1969 to $12.38 in 1973-74. In the first five year plan 41.2 billion Saudi Riyals were granted for expenditure.\(^{26}\) whereas real spending on various development projects reached 34.1 billion Saudi Riyals or US$ 9.1 billion.\(^{27}\) The general objectives of first five year plan according to a report prepared by central planning organization were, to institute an economic and

\(^{26}\) SAMA Annual Report, 1975, pp.12-13
social development policy for Saudi society, in which Islamic and religious virtues could be maintained, a rise in the living standards and welfare of the people achieved, and which would provide for material, economic and social stability. The next stage had been to develop the human resources necessary to implement the economic transformation. Those objectives were to be achieved by increasing GDP by 10 percent per year; developing human resources so that the Saudis would be able to replace the foreign skilled manpower required in the initial stages of development; diversifying sources of national income and reducing dependence on oil, and bringing scientific rationality in the public sector programs and integrating activities to ensure coordination.

During the first three years of implementation of 1st. plan, 60 percent of the funds were spent. The government then realized lacunae in the way the funds were allocated. It realized that diversifying the sources of national income and the reduction of dependence on oil could not be achieved by a 3.6 percent allocation to agriculture, and a 2.7 percent allocation to industry. As a result a public investment fund was established during the 1971-72 fiscal year with an initial budget of Saudi Riyals 350 million, with further addition of Saudi Riyals 250 million in 1972-73 and Saudi Riyals 600 million in 1973-74. The funds were planned to be increased every fiscal year until they reached Saudi Riyals 2000 million. The basic intention behind the establishment of this
fund was to provide financial inducement with government backing in a capitalist economy in order to encourage the unwillingness of the private sector to invest in industrial and agricultural projects required for development. Financial inducement and the backing of the government did have an impact on the private sector, but not in the direction intended by the plan.

During the period of the 1st. plan, the agricultural labour force had been decreasing by 1 percent per year. This was the result of the inflation which caused poverty among the farmers, and the demand for labour in the new construction activities. According to the Central Planning Organisation (CPO) which probably over stated the actual rate of growth, agricultural production increased by 3.6 percent, which was less than what the plan had aimed for. In the industrial field investment by the private sector followed the same course they would have taken if the five year plan and the inducement policy had not existed. Only short term investments were made, such as real estate, construction and trade activities such as exports. Thus the five year plan produced only a group of wealthy merchants who were dependent on government expenditure for their continuing prosperity. The first five year plan also created a boom in the construction sector. Cities and towns witnessed a
phenomenal growth in size and density. The decline in rural employment forced Saudi’s to move to the cities. This, in addition to the massive importation of foreign skilled manpower, created a market for housing.

In the era of transportation, the plan’s target was largely met ahead of the schedule. This was due to the nature of business involved. At the same time, transportation expenditures gave more work to contractors. Over 500 kilometers of main and secondary roads were completed in 1971 and an equivalent number in 1972. The port of Jeddah was finished in 1972. Airports were completed in Medina, Taif, Tabuk and Khomus Mouslouf. With respect to the objectives of the first five year plan, it is safe to say that by the end of 1974 the plan has raised the standard of living and welfare of urban people by providing material security, creating new jobs and maintaining economic and social stability. But these objectives were not achieved by the means the plan had hoped for, diversifying the sources of national income and reducing dependence on oil.

In brief, the first five year plan by the manner in which it was implemented, indirectly accelerated the growth of urban areas, creating a massive concentration of population in less than ten big cities. At the

same time, it enlarged the size of the middle class and created a new type of lower class. By the end of 1975, Saudi’s social structure was remarkably changed. It was easy to distinguish classes according to their social status, profession and the way they earned their living. Finally the focus shifted to economic diversification, including the expansion of the industrial and agricultural sector.

The Second Five Year Plan:

The second five year plan covers the period 1975-80. In the second five year plan, the government having increased wealth from higher oil revenues, permitted the plan to make a much strong approach. At that time there were reasonable doubts as to whether a substantial proportion of the $142 billion allocated in the plan would ever be spent. Economist expressed concern about the absorptive capacity of the Saudi economy.30 But actual spendings were only $92.6 billion or 347.2 billion Saudi Riyals about 10 folds the resources spent during the first five year plan.31

The second five year plan was more successful than the first plan. However, the goals set up in the second plan were not fully achieved. The $142 billion was over spent in current value terms. The 15 percent annual inflation rate anticipated in the second plan was an under

30. Optic. 28, p.640
31. Opcit. 27, p.24
estimate, since according to Saudi official figure, the rate of inflation has exceeded 30 percent since 1977, while in actuality the rate of inflation was well in excess of 45 percent. That factor of domestic inflation, when combined with the effect of international inflation, gives us a clear picture of the difficulties that the second five year plan guidelines were facing. The most important characteristics about the second plan was the introduction of a framework of ten years and twenty years planning to provide a long range perspective for the five year plan. This approach was considered by economists as a more appropriate method than the first five year plan. The government decided to increase its reliance on free enterprise even though the private sector had failed to achieve the goals set out in the first five year plan. In the second five year plan the Central Planning Organisation (CPO) perceived that OPEC was gaining the upper hand, imposing its prices in the oil market. Saudi Arabia, being the most powerful in OPEC, with one fourth of the world’s proven oil resources, made the CPO secure enough to its plan for industrial diversification. Saudi Arabia adopted a strategy of specialization in resource development designed to maximize natural resources in oil and minerals.

The second plan, covering the period 1975-80 was designed and implemented in much more favorable circumstances than its predecessor.

32. Opcit. 21 p.D6
as a result of the quadrupling of oil revenues between 1973-74. The issue was less of one of resource constraint than of the country’s ability to absorb this new revenue in production investment. The emphasis on education and training continued, but ambitions could be scaled up, although it was recognized that a doubling of the foreign workers, including teachers, would be required. The cornerstone of the plan, however, was the creation of two new industrial cities at Jubail and Yanbu, where major world class petro-chemicals, steel and aluminium, refining and desalinization plants were to be located.33

Awareness of the fact that the government surplus would exceed the absorptive capacity of the Saudi economy, led to two decisions:

1. To limit oil production
2. To invest enough of the surplus abroad. This was to ensure that income from these investments would support the Saudi economic growth after the revenues from oil declined.

The most important feature of the second plan was its emphasis on the development of a modern petro-chemical sector based on the construction of two huge industrial states, one at Jubail near Dhahran, the other at Yanbu on the red sea, complete with water, electricity, houses, hospitals and modern ports, and provided with both feedstock and energy by twin oil and gas pipelines completed in 1981. These were

33 Middle East Economic Digest, July 1985, p.16
then used as a base for a member of enterprises founded and funded by a new state organization, Saudi Basic Industries Corporation (SABIC, founded in 1976). The period of the second plan also saw important initiatives which had a more immediate effect on output. It was also the use of yet another new organization, The Saudi Industrial Fund (SIDF), to encourage the development of private industrial sector through the provisions of expertise and long term credit. The second initiative of the second plan was the subsidies given to local agricultures to encourage the production of wheat and other cereals with the aim of achieving food security. These were very effective in the sense that they caused the wheat harvest increase fourfold during the 1970s.

Contrary to what was expected of the first and second development plans, the government of Saudi Arabia proved to be a dominant moving force in the whole process. The private sector became more dependent than ever on government spending, both directly through expenditure allocated for infrastructure and industrial projects, and indirectly through loan and subsidies. Revenue from crude oil export were still what held the state economy and policy together. This means that the implementation of the first & second five year plans brought Saudi Arabia to the point where any reduction in the country’s oil production meant a disaster for the Saudi economy and government.
The Third Five Year Plan:

The third five year development plan covers the period 1980-85. The aim of the third plan was to promote the role of individual initiatives throughout the society, and particularly in the economic life of the nation. The plan ever linked the promotion of social values to free enterprise and private ownership.

The objectives of the third plan were as follows.

1. The government would uphold Islam and will maintain its associated cultural value, by applying, propagating and fostering God’s Sharia.

2. The defence of the religion and the country should be assured as well as the internal security and the social stability of the Saudi Arabia.

3. Government support for free enterprise should continue.

4. Economic growth should be balanced by developing the country’s resources, by increasing the income from oil over the long term and by conserving deplettable resources.

5. The social well-being of all citizens should be improved and economic strength to attain all the other fundamental goals of development should be provided.

6. Dependence on the production of crude oil as the primary source of national income should be reduced.
7. Human resources through education training and the health standards should be developed.

8. The basic infrastructure required for the attainment of those other goals should be completed.\textsuperscript{34}

The third five year plan was published in the midst of the oil price explosion in 1980. Here some of their stated aims were rapidly overtaken by events for instance that of preventing the further expansion of the foreign labour force. But others such as diversification of the economy and the encouragement of the private sector, proceeded more or less as planned, although at the expense of drawing down reserves and a growing budget deficit towards the end of the decades. It is difficult to evaluate the total impact of all these new initiatives during 1980s. Clearly, the expenditure of very large sums of money had created the beginning of the state industrial sector, together with an associated private sector, heavily dependent upon the state for credit and contracts. But as both remained highly subsidized, as well as highly protected from competition, there was no way how their products would have fared if sold for profits in the world market.\textsuperscript{35}

Through the third plan, the Saudi government had an over all goal, which was to consolidate rather than expand the foreign labour force. This was to be achieved by emphasizing capital intensive

\textsuperscript{34} Op cit. 5, p.25
\textsuperscript{35} Faud Al-Farsy, "Modernity and Tradition" Kegan Paul International London and New York, 1990, pp.158-159
development in hydrocarbon and other manufacturing industries, in agriculture and in mining. The government, under severe pressure from the traditionalists decided that its growth targets in the third plan were to be constrained by a policy requiring new employment to correspond as closely as possible to the domestic availability of new Saudi manpower. To be consistent with the general plan of development, the third plan included an increased level of expenditure on human resource development.

Considering the rate of growth projected in the third plan, the employment estimates were inadequate for three reasons.

1. The projected rate of productivity were extremely high, taking into consideration the limited man power provided, especially in agriculture, utilities and commerce.

2. The growth of construction, considering the funds allocated to this sector, was unrealistically low.

3. The Saudi labour force has been only educated and trained. This means that it lacks experience. Labour in Saudi Arabia is not homogeneous, because of cultural and historical constraints. Business international conducted its own research and came up with the conclusion that the foreign workforce
rose to over 1.2 million in 1985, an annual growth of 3.8 percent, which is higher than the growth of Saudi population.\textsuperscript{36}

The goals were easy to be achieved, but as the civil service and the state sector became ever more obliged to absorb Saudi Arabian graduates to create employment, this conflicted with the goal of administrative efficiency. Substantial investment in education continued, but issues such as the quality of provision were not addressed.\textsuperscript{37} Under the third plan, manpower development was given the highest national priority. Education at the primary, intermediate, secondary and university levels was geared to the needs of the society. Above, intermediate level, there was to be streaming of the students to ensure that sufficient students remained in formal education and that the kingdom’s requirement for skilled technicians were taken into account. The private sector was encouraged to expand training programs and government loans were to be made dependent upon the provision of full training scheme for Saudi citizens in the project. At the same time, Saudi citizens were encouraged, through incentives, to enroll in training courses for technical and skilled jobs. Surplus manpower, currently employed in areas with limited economic potential, was encouraged to move to work in high growth sectors of the economy. A special effort

\textsuperscript{36} Ibid..... p.160
\textsuperscript{37} Ibid..... pp.163-164
was made, through government sponsored research, to devise plans for the most effective use of manpower in general.  

Both the policy of requiring the Saudi private sector to play a crucial role in diversifying the Saudi economy and the emphasis on the training and use of Saudi manpower indicated the government’s awareness of the need to involve Saudi citizens as much as possible in the future development of their own society.

Fourth Development Plan:

The fourth five year development plan covered the period 1985-90, which also includes the international oil price collapse in 1986. The fourth plan was mostly continuation of the principles and policies of the third plan. There were four broad themes which characterized and differentiated it from third development plan. These were —

1. A greater concern with the efficiency of operations and uses of the Saudi Arabia’s resources and facilities, with the discovery and development of renewable alternatives.

2. A strong focus of the diversification strategy on development of the producing activities, particularly manufacturing, agriculture and finance.

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38. Ibid.... p.165
3. A commitment to reduce the number of foreign labour in Saudi Arabia by more than half a million.

4. A clear cut emphasis on promoting the private sector's investment in economic development.

**Objectives of the Fourth Development Plan:**

There were ten objectives of the fourth development plan. These were as follows —

1. To safeguard Islamic values, duly observing, disseminating and confirming Allah’s Shari’ah.
2. To defend the faith and the nation and to uphold the security and social stability of the country.
3. To develop human resources thus ensuring a constant supply of manpower and upgrading and improving its efficiency to serve all sectors.
4. To raise cultural standards to keep pace with the development of Saudi Arabia.
5. To reduce dependence on the production and export of crude oil as the main source of national income.
6. To continue with the real structural changes in the Saudi Arabia's economy through continuous transformation to
produce a diversified economic base, with due emphasis on industry and agriculture.

7. To develop mineral resources and to encourage discovery and utilization thereof.

8. To concentrate on qualitative development through improving and further developing the performance of the utilities and facilities already established during the three development plan periods.

9. To complete the infrastructural projects necessary to achieve over all development.

10. To achieve economic and social integration between the member countries of Gulf Cooperation Council.

The total government expenditure in the fourth development plan was set at Saudi Riyal 1,000 billion. Of this Saudi Riyal 500 billion was to be devoted to development expenditure. The largest share of development expenditure, 27.1 percent, was allocated to human resource development, economic resources received 26.1 percent, health and social services 17.9 percent, transport and telecommunication 15.4 percent and municipalities and housing 13.5 percent. The amount allocated for the economy and human resources and health and social services was more than the actual spending on these sectors during the third development plan. The percentage increase ranged between 28.9
percent for health and social services, and 8.6 percent for economic resources. However, the basic infrastructure allocation was lower. The reasons for these were—

1. Confirmity with the strategic principle that emphasizes development of the producing sector.

2. Most of the infrastructure project has already been completed.

3. It was expected that project cost would be reduced through the implementation of programs concerned with the modification of construction specification, reducing the scope of projects and through higher competition in the market.

The number of projects to be completed over the plan period totaled 3226 of which 1444 were new, and 1782 under construction and scheduled to be completed during the fourth development plan period.

The budgetary sums envisaged for government expenditure in the fourth development plan were not realized. In the year 1985, oil production amounted to an average of only 3.565 million barrels of oil a day, compared with almost 10 million barrel a day in 1980-81. Revenues from oil had fallen from SR 361,000 million in the year 1980-81 to SR 90,000 million in the year 1985-86. Despite budgetary restrictions, the fourth development plan provided firm guidelines for the
implementation of government policies in all areas of the Saudi Arabia economy.\textsuperscript{39}

It is difficult to evaluate the total impact of all these new initiatives as of the year 1990. Clearly the expenditure of very large sums of money had created the beginning of a state industry sector together with an associated private sector heavily dependent upon it for credit and contracts. But as both remained highly subsidized, as well as highly protected from foreign competition, there is no way to assess how efficient they had been and how their products would have fared if sold for profits in the world market.

During the period of the third and fourth development plans in the 1980s the oil revenues position was much less satisfactory and funds to finance investment had to be cut and ambitions scaled down. Hence, there was more emphasis on consolidation and on completing existing projects rather than on new ventures. The theme of economic diversification and human resource development continued, but stress was laid on increased economic and administrative efficiency and the development of other minerals besides oil, although little progress was made on the latter.

\textsuperscript{39} Opcit. 27, pp.25-26
The Fifth Development Plan:

The fifth five year plan covers the period 1990-95. The completion of the infrastructure and many industrial agricultural development projects, together with the downturn in oil revenues, having reinforced the shift in strategy had been clearly discernible in the fourth development plan. Apart from the preservation of Islam defense of the kingdom and education of the citizenry, the emphasis now was firmly on encouraging the private sector to build up on the economic foundation laid by government.

The objectives of the fifth development plan in Saudi Arabia were defined as follows —

1. To preserve Islamic value, duly observing, promulgating and confirming Allah’s Shari’ah.

2. To develop human resources, thus ensuring a constant supply of manpower, and upgrading and improving its efficiency to carry out the requirement of national economy.

3. To raise cultural and informational standard to keep pace with Saudi Arabia’s development.

4. To reduce dependence on the production and export of crude oil as the main source of national income.

5. To continue with real structural changes in the Saudi Arabia economy through continuous transformation to produce a
diversified economic base with due emphasis on industry and agriculture.

6. To concentrate on qualitative development through improving and further developing the performance of the utilities and facilities.

7. To continue with encouraging the private sector participation in social and economic development.

8. To achieve balanced development between the different regions of Saudi Arabia.

9. To complete the infrastructural projects necessary to achieve overall development.

10. To achieve economic and social integration between the Arab Gulf Cooperation Council countries.\(^{40}\)

In the fifth plan the emphasis was on continuation, but again the planners reiterated the familiar calls for greater economic diversity, an enhanced role for the private sector, investment in education and the creation of more employment for Saudis. Investment in education could have been increased if, say defense spending had been reduced, but the later was outside the kingdom of the plans even though it accounted for over one-third of the government spending.

\(^{40}\) Op cit. 29 pp. 55-56
By the late 1990s it was apparent that the ministry of planning was becoming increasingly ineffective and that reform of economic management was needed to ensure at least a degree of coordination between spending ministries, if not their political control. Although it would have been a mistake to characterize the kingdom as experiencing an economic crisis, unemployment was rising, especially among the youth, an increasing amount of government revenues was simply being used to service debt, and the economy did not seem to be heading in any clear direction. The flight of capital continued, there was little foreign investment, and the various joint venture arrangements dating from the 1970s involving overseas involvement in the banking sector and SABIC seemed to be fossilized.

There has been some economic vision back in the 1970's, with the planning of the new industrial cities in Jubail and Yanbu and the implementation of major infrastructure schemes, as well as the spread of schools and hospitals throughout Saudi Arabia. But by the late 1990’s the government seemed to have stalled and there was drift in economic management, which subsequently led to the formation of Supreme Economic Council.\(^{41}\)

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41. SAGIA – *Economic Strategy and Plans*, 2005
The Sixth Five Year Plan:

The implementation of the country's sixth five year plan's (1995-2000) emphasis had been placed on the expanding role of the private sector. At that time the emphasis on the role of the private sector can be explained by —

(a) The need of economic diversification to lessen the current heavy dependency on the oil sector in economic development.

(b) The need to reduce the vulnerability of the domestic economy to external economic shocks reflected in particular in the fluctuation in oil prices and revenues.

(c) The need to increase gross domestic investment by fuelling additional private sector investment to the gross domestic investment including the foreign private sector investment.

The Saudi economy taking into consideration the massive opportunities it provides, together with the application of conducive and stable macro-economic policy also provides stable institutional and regulatory framework. There is at the same time a great potential for the expansion of the private sector investment, and hence, its role in the economy. The need for huge investment to expand the infrastructure sector and exploit the country's huge mineral reserves, provides both
incentive and encouragement for substantial increase in the role of the private sector in the economy. The adoption of new law and regulations, particularly the new investment law on the one hand, and the opening up of new economic sector to the participation of the private investment on the other hand would boost the share of the private sector in the economy. This share is already substantial in non-oil sector and with opening up of the energy and mineral sectors will boost this contribution in the economy as a whole.

The private sector plays an important role in the non-oil economy which is also significant for employment generation in the kingdom. The share of private sector in the employment is even higher than its share in Gross Domestic Product. During 1995-2000 period its share in employment rose slightly from 88.1 percent to 88.3 percent. Furthermore the private sector accounted for 95 percent of employment generated during the period of 1995-2000. This high share stems from the fact that the non-oil sector, where the private sector has a major share, accounted for 99.2 percent of total employment in Saudi Arabia during the period 1995-2000. The share of oil related activities in total Saudi employment was less than one percent during the same period.\textsuperscript{50}

The Supreme Economic Council was set up during the six plan period, largely because the oil prices falls of 1998 and their economic impact brought development issues higher up in the political agenda.
The remit of the Supreme Economic Council includes responsibility not only for development planning but also for fiscal and trade policy. This enables it to survey both short-term economic management and long-run strategy and also to focus on imbalances in both internal budgetary and external payments. The aim is also to design new policies, of which the most notable during its first two years of operation were the new law on foreign investment and the establishment of both the General Investment Authority and the Human Resource Development Fund.

The Seventh Five Year Plan:

The Supreme Economic Council also had some input into the final drafting of the seventh five year plan that covers the period 2000-2005, although a great deal of the content had been written before hand. Targets in the original drafts of the seventh plan were revised upwards as the planners became more confident, with oil revenues exceeding 62 billion dollars in 2000, almost double of the 32 billion dollar original forecast, and with the surplus on the current account of the balance of payment rising to 21 billion dollars. The seventh plan provided a detail list of macro-economic objectives and much information on goals set for each sector of the economy.
The seventh five year plan was approved by the Council of Ministers in September 2000. It was hoped that 817,000 additional jobs could be provided by 2005. Initially, with the budget in surplus, thanks to higher oil prices, the plan looked to have much more chances of success than either the fifth or sixth. The target in the seventh plan looked ambitious given the performance of the Saudi Arabian economy in 1990s, but by 2000 they seemed quite modest and conservative. The planned target was for real GDP growth to average 3.16 percent over the period 2000-2005; but the growth in 2000 exceeded 15 percent. With the higher prices of that year the ambitious investment target also seemed more attainable, as the plan envisaged an average investment growth of 6.85% annually and the share of investment in GDP rise from 22.7 percent to 25.4 percent. The petroleum revenue windfall of 1999-2000 proved a mixed blessing as it reduced the pressures on the government for economic reform. Although there was much discussion of the new investment laws introduced in the 2000, permitting the foreign ownership of new industrial ventures in many fields. Reforms aimed at attracting external involvement can be no substitute for domestic reforms. The seventh plan discussed privatization policy, but in very general terms rather than providing a list of activities to be privatized. There was no discussion of how privatization was to be achieved.
Eight Five Year Plan:

The eight five year plan covers the period 2005-09. This plan represents the major landmark in the social and economic development path of Saudi Arabia, as it is the first five year plan prepared in the context of a long-term development strategy with definite targets and objectives. The 8th development plan aims to support the efforts of the private sector and its contribution to diversification of the economic base as well as increasing the future role of this sector in the production activities through development of the institutional and organizational framework. The objectives of the 8th five year plan are as follows—

1. To safeguard Islamic teaching and values, enhance national unity, uphold the social stability.

2. To continue improving the services provided to Hajj and Umrah performers so as to facilitate performance of religious rites with ease.

3. To raise the standard of living, improve the quality of life and provide job opportunities to citizens by accelerating the development process, increasing the rate of economic growth along with ensuring enhancement in the quantity and quality of education, health and social services.
4. To develop human resources, upgrade their efficiency and increase the supply of manpower to meet the requirement of the national economy.

5. To diversify the economic base with due emphasis on promising areas such as manufacturing industries, particularly energy and related derivatives, as well as mining, tourism and information technology industries.

6. To enhance the private sector’s participation in socio-economic development.

7. To develop the science and technology system, pay attention to information, support and encourage scientific research and technology development with a view to enhance the efficiency of the Saudi economy.

8. To protect the environment and develop suitable system in the context of sustainable development requirement.51

The objectives of the 8th development plan of Saudi Arabia were based on the following strategy. These were —

(a) Increase the share of Saudi manpower in total employment in various sectors and pay attention to upgrade their efficiency and productivity to the level of non-Saudi manpower.
(b) Expand the provision of healthcare and social welfare service to the entire population.

(c) Develop all relevant aspects of education and training system.

(d) Improve the quality of public services and increase their supply in line with the growing needs of the population.

(e) Continue to pay attention to prepare a climate conducive to boost private sector participation in the socio-economic development.

(f) Adopt a population policy that takes into consideration the quantitative and qualitative aspects of the population and their geographical distribution, and enhance the correlation between population variables and direction of sustainable development.

(g) Continue with the process of administrative development and creation of a regulatory environment conducive to economic development and efficiency.

(h) Adopt fiscal and monetary policies that contribute to accelerating economic growth, realizing a higher employment level and enhancing economic stability.

Finally the 8th development plan strategy of Saudi Arabia was to promote integration among the Gulf Cooperation Council Countries and
strengthen the relation of Saudi Arabia with Arab, Islamic and friendly countries as well as international economic blocks.

Over all development strategy stems from the recognition that sustainable long-term development requires a reduced dependence on the exploitation of depletable crude oil resources as the main source of national income. Thus each development plan put a high priority on establishing other strong economic sectors, and diversified income sources to meet the need of a rapidly growing population.