The purpose of this chapter is to assess the extent to which Saudi Arabia's long-term economic development strategy is meeting its objectives. Early on after the 1973-74 oil boom, the government decided that a high proportion of the country's oil revenues should be spent in a manner that would encourage private sector investment and production. Part of a larger political/military strategy, the economic component was to diversify the economy away from oil to the extent that self-sustaining growth could occur in the major non-oil sectors of the economy. Clearly, the goal is the creation of an economy capable of functioning independently of developments in the oil sector. This strategy was intended to provide more stability to the country's pattern of economic growth and development, and while several oil-producing countries express this desire, the Kingdom's planners put together a coherent investment strategy, focused on achieving this result. At least publicly, the strategy has remained in place since the early 1970s.

While goals of this strategy seem straightforward, arriving at an objective assessment of progress made to date is extremely difficult. Examining the patterns of private sector growth does not necessarily come to grips with the issue. Output can expand simply through a continuation of government expenditures or momentum from past public allocations. If one could show that, over time, a linkage from private expenditures to private output was growing stronger than that of public expenditures to private output, then one might argue that the economy had evolved a bit, but that private expenditures themselves could not be sustained without a steady infusion of government funds. Conceptually, therefore, the methods by which one defines and measures oil independence are at the crux of assessing the success of the country's development accomplishments.

The chapter is divided into several parts. The first sections provide a brief overview of the macro-economy. Trends in output and expenditure are examined, and the more relevant patterns identified. Several linkages are made to earlier studies of the country's growth mechanisms. The second part of the study
develops an operational test for measuring the extent to which the private sector is replacing government expenditures as the prime mover of the non-oil sector. Relatively new statistical techniques are introduced, including co-integration and error correction, to shed light on various issues. Based on this discussion, particular statistical tests are devised to measure changes over time in the Kingdom’s economic mechanisms. Ultimately, these tools are used to ascertain whether the public sector is becoming less dominant and in what sense, and whether the private sector is showing that it is now primarily responsible for large segments of non-oil sector growth. Once these questions are properly assessed, and based on the results of this analysis, the final section discusses several policy implications.

Patterns of Growth and Expenditure, 1964–1998

Saudi Arabia has experienced periods of remarkable growth and other periods of relative stability and even decline. For the 1964–98 period as a whole, gross domestic product (GDP) at constant prices increased at an average annual rate of 5.7 percent, but with private sector GDP and non-oil GDP increasing at an even faster 6.8 and 6.7 percent, respectively (Table 9.1). Public expenditures experienced a sharp deceleration, increasing by double digits in the 1964–80 period, but with negative rates associated in investment and non-defense disbursements during the subsequent period. Private expenditures were a bit more stable, but these too experienced a general downtrend in the latter time periods.

Several other patterns emerge out of these data. First, after an initial surge following the 1973–74 oil price increases, public sector investment/infrastructure expansion was flat, actually experiencing a fairly large (-6.4 percent per annum) contraction over the 1980–98 period. Second, public consumption was the only major category of governmental expenditures to indicate a positive rate of growth in the post-1980 period. Third, of major government expenditure categories, defense was the fastest-growing sector during the last decade (1989–98). Fourth, and in contrast, private sector investment generally expanded more rapidly than consumption over the 1980–98 time frame. Fifth, the general pattern of private sector expenditures was considerably more stable than those of the public sector. Sixth, construction was by far the most volatile sector, growing at an average annual rate of 42.3 percent during the 1964–80 period, but at a -0.3 percent rate during the 1980–98 period. Finally, and ironically, one of the fastest-growing sectors, agriculture, was the one in which the country enjoyed the least natural advantages.

Despite Riyadh’s persistent efforts to diversify the economy away from oil, the hydrocarbon industry is still dominant in several important regards. Oil production still accounts for roughly 30 percent of GDP, 90 percent of exports, and 70 percent of budget revenues. Therefore, the economy remains highly vulnerable to fluctuations in international oil markets. This is readily apparent, as in 1998, when nominal GDP contracted by 12 percent, mainly due to a 25-year low price of Arabian Light, the benchmark Saudi crude, averaging below $12 a