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and Their Implications
for the United States

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SAUDI ARABIA

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SAUDI ARABIA: KEY ECONOMIC INDICATORS

All values in billions of current U.S. dollars unless otherwise indicated

Exchange Rate: 1978 US\$1.00=SR 3.3996 1979 US\$1.00=SR 3.3608 1980 US\$1.00=SR 3.36e	A) FY 1977/8*	B) FY 1978/9*	B/A % Change	D) FY 1979/80* Forecast	D/B % Change Forecast
INCOME AND PRODUCTION					
Gross Domestic Product (GDP)	64.2	75.6	+17.8	112	+48
GDP Per Capita (Dollars) ^{1/}	8,410	9,603	+14.2	13,750	+43
Non-Oil GDP	25.2	32.4	+27.1	41	+26
Non-Oil GDP (at 1969/70 prices)	5.8	6.8	+17.2	7.8	+15
GOVERNMENT BUDGET					
Budgeted Revenue	42.3	38.5	- 9.0	47.6	+24
Budgeted Expenditure	32.2	38.5	+19.6	47.6	+24
Actual Revenue	37.7	39.3	+ 4.2	74	+88
Of which Oil Revenue	32.9	34.2	+ 4.0	68	+99.
Actual Expenditure	39.8	43.6	+ 9.5	60	+38
Surplus or Deficit	-2.1	-4.3	-105	+14	-
MONEY, PRICES					
Inflation (Non-oil GDP Deflator) (% increase)	14.5	9.2	-	11	-
Money Supply (% increase in M3)	43.6	14.5	-	20	-
Income velocity of money (M3)	1.99	1.91	-4.0	1.87	-2.1
	1978	1979	1979/78 %change	1980 Forecast	1979/80 % Change Forecast
OIL, MONEY, PRICES					
Crude Oil Production (million bbl/day)	8.3	9.5e	+14.5	9.7 ^{2/}	+2.1
Total Government (SAMA) Foreign Assets	58.5	59.5 ^{3/}	+ 1.7	N/A	N/A
Current Account Balance	-1.0	+14e	-	30+	200+
Exports (FOB)	37.9	59.3	+56.5	88	+48
U.S. Share (%)	13.7	14.7e	+ 7.3e	15	No Change
Imports (CIF)	20.4	25.5e	+25e	32	+25
U.S. Share (%)	20.9	21.0e	No Change	21	No Change

Total Imports from the U.S. in 1979 \$4.875 billion (FOB)

Principal Imports from U.S.: cars and trucks; aircraft and avionics; cereals and preparations; electric power equipment; construction and mining equipment; heating and cooling equipment.

e = estimated

* Saudi Fiscal Year 1977/78 June 17, 1977 to June 5, 1978
1978/79 June 6, 1978 to May 26, 1979
1979/80 May 27, 1979 to May 15, 1980

^{1/} Uses IMF population data

^{2/} First half of 1980, including Saudi share of Neutral Zone

^{3/} As of October 30, 1979

Sources: Saudi Arabian Monetary Agency; Ministry of Finance Central Department of Statistics; International Monetary Fund; Embassy estimates.

SUMMARY

After several years of relative stability in oil revenue and government spending, Saudi oil income rose significantly in 1979 and should again show substantial growth in 1980. Unlike the similar situation which followed the 1973/74 oil price explosion, the Saudi Government is now better prepared to channel increased wealth into existing programs and projects. Though government spending rose at a higher rate in Saudi fiscal year 1979/80 than during the preceding two years, both inflation and the social consequences of increasing government outlays are being carefully monitored in light of lessons learned during the post-1973 period when inflation peaked at over forty percent.

On the balance of payments front, there was a significant current account surplus in 1979, which should at least double in 1980.

Increased government spending should provide new opportunities for U.S. suppliers, particularly those firms specializing in maintenance, operations, and training services or companies interested in a joint venture with a Saudi firm. The construction sector remains fiercely competitive. The U.S. market share in construction in Saudi Arabia has dropped to three percent.

CURRENT ECONOMIC SITUATION AND TRENDS

OIL SECTOR

Despite unprecedented growth in the non-oil segment of the economy during the past five years, production of crude and refined petroleum and natural gas still accounts for two-thirds of gross domestic product (GDP), the lion's share of Saudi Government budget receipts, and virtually all exports. Many of the major macroeconomic measures of the performance of the Saudi economy are therefore heavily dependent on external events which influence the price and demand for Saudi oil. During 1979, the selling price of Saudi oil almost doubled from \$13.34/barrel to \$26/barrel, while production averaged more than a million barrels per day above 1978 output. This resulted in astronomical growth rates for GDP, exports, and government revenue, as well as a significant surplus in external accounts, and an increase in Saudi holdings of investments abroad. High oil prices and production plus increased natural gas liquids sales should cause these economic indicators to show substantial growth again in 1980 (See Table).

Progress continues rapidly on oil and gas projects within the Kingdom as the Saudi Government moves to increase the domestic value-added to its crude oil production. Phase one of the master gas gathering system began to go on stream during the first quarter of this year. The completion of this project in 1983 is slated to increase from 3 million tons/year to 8.8 million tons/year, the amount of NGL which the state agency charged with developing and promoting the petroleum and minerals industries, Petromin, will have available to market. This project, when fully operational, will make Saudi Arabia the world's largest exporter of propane and butane and will eliminate most of the wasteful flaring of natural gas. In addition, it will generate large quantities of feedstocks for the petrochemical industries soon to be established in the Kingdom and provide sweet dry gas as fuel for the modern industrial city of Jubail and other industries in the Eastern

Province. By 1982 the oil and natural gas liquids (NGL) pipelines from the Eastern Province to the new industrial city of Yanbu on the west coast are due to be completed. This will make NGL from the master gas gathering system, as well as crude oil, available for export and as an input for the petrochemical and refining industries being established at Yanbu.

Petromin has been increasingly active in direct oil marketing, offshore refining, and domestic refinery construction. The Governor of Petromin, Dr. Abdul Hadi Taher, recently announced in an interview with the local press that Petromin's direct crude oil export sales amounted to 1.4 million barrels per day. This is more than double last year's direct sales by Petromin, which generally prefers government to government direct marketing arrangements. Direct sales have been reported with firms (usually government-owned) in the following countries:

Austria	Japan
Bangladesh	Pakistan
Brazil	Philippines
Denmark	South Korea
France	Spain
West Germany	Sri Lanka
Greece	Sudan
India	Sweden
Ireland	Taiwan
Italy	Thailand

In addition, Petromin is marketing increasing quantities of NGL and has contracted with European refiners to process approximately 185,000 barrels/day of Saudi crude oil on Petromin's account.

As part of the Government's overall plan to industrialize, Petromin has been active in establishing refinery and lubricating oil plants. Three 250,000 barrel/day export refineries are underway, each a joint venture with a different foreign partner - Shell in Jubail, Mobil in Yanbu, and Petrola in Rabigh. To serve the domestic market, a 170,000 barrel/day refinery is under construction Yanbu and a 250,000 barrel per day refinery at Ju'aymah near Ras Tanura has just been approved. The Mobil/Petromin lube plant in Jidda was recently expanded significantly. An Ashland/Petromin lube project in Rabigh was recently announced and a Texaco/Socal/Petromin lube plant for Jubail is under study.

The Saudi Arabian Basic Industries Corporation (SABIC), the Saudi Government entity responsible for development of the petrochemical industry, is in the process of signing a number of final contracts with foreign joint venture partners for the key installations at the two new industrial cities of Jubail and Yanbu. These projects are at the heart of the Saudi drive to industrialize and modernize the economy. One of the major goals of the Second Development Plan 1975-1980 was to provide the infrastructure for these two new cities. The actual construction of these industrial installations will be a primary goal of the Third Plan (1980-1985) which is to be unveiled soon. For Jubail, joint venture agreements for projects have been signed with a Japanese consortium for a methanol plant, with Korf Steel for a steel mill, and with Exxon for a low-

density polyethylene petrochemical complex. Press articles have reported the imminent signature of agreements with Pecten (US Shell) for an ethylene-based petrochemical complex and with Dow Chemical for a second ethylene-based complex. A Japanese consortium headed by Mitsubishi has signed an agreement for a design/feasibility study for a 450,000 ton/year ethylene core unit at Jubail. For Yanbu, Mobil signed a final agreement for a 450,000 ton/year ethylene complex due to be operational in 1984 or early 1985. After frequent delays in negotiations, both the Saudis and their foreign joint venture partners now appear eager to push for expeditious implementation of these key heavy industry projects in refining and petrochemicals.

NON-OIL SECTOR DEVELOPMENTS

In real riyal terms, the non-oil sector has grown at close to 14 percent annually during the past two Saudi fiscal years (1977/78 and 1978/79). Rising government expenditure should cause a somewhat higher rate of non-oil output expansion during the current fiscal year which ends in May, though government spending, the principal stimulus to non-oil growth, appears likely to have increased more slowly than receipts for several reasons. After experiencing inflation rates of over forty percent in the mid-seventies, the government is very conscious of the dangers to price stability of excessively rapid increases in outlays. During the budget trimming exercises of 1978/79, a number of measures were adopted to insure greater efficiency in procurement. These cost control measures are unlikely to be removed even though inflation has abated and budget deficits have disappeared. Policymakers have also become more aware of the social costs of rapid modernization. After the chaotic mid-seventies boom Saudi economic officials, while still committed to growth and development, are apt to continue to be more cautious in their spending plans.

Even if spending increases only half as rapidly as income, the increase would be substantial. However, several factors have tended to moderate the impact of this increased spending on domestic non-oil sector output in fiscal year 1979/80. At the end of FY1978/79, many domestic and foreign contractors held significant government receivables on their books. The Government was therefore in a position in 1979/80 to liquidate some of these obligations without generating any additional economic activity. Also, as the economy becomes more sophisticated, demand for bank balances increases, reducing the velocity of money and therefore the inflationary impact of a given level of spending. As rates of return on investments in the Kingdom stabilized and overseas interest rates soared, more Saudi private investment moved abroad, again reducing the impact of increased government spending on domestic non-oil growth. Despite all of these mitigating factors, the substantial growth in government outlays appears sufficient to sustain non-oil GDP growth in FY 1980 at rates somewhat higher than last year's.

Construction predominates among non-oil sector activities, accounting for over a third of total non-oil output. Trading, transport and real estate together comprise another third while the "productive sectors" of industry and agriculture, the main targets of the Third Plan, currently generate less than ten percent of non-oil GDP. The past several years have witnessed sharply increased competition in the traditional non-oil sector pursuits - most noticeably in construction but also in real estate, supermarkets and hotels. Within the industrial sphere,

building materials and supplies manufacturing seems to have provided the most popular initiation to most Saudi entrepreneurs, followed by consumer items for the local market (e.g., plastics, milk, bakeries, ice cream, appliances, soft drinks, rugs). A cable factory was recently inaugurated. As petrochemical complexes are established at Jubail and Yanbu, vast opportunities will arise for private sector firms which can either provide goods and services to these new industries or utilize the products of these installations.

PUBLIC FINANCE

Statistics released in the Annual Report of the Saudi Arabian Monetary Agency this spring indicate a government operating deficit for the last two fiscal years for which data are available - 1977/78 and 1978/79. However, the dramatic oil price increases of late 1979 should result in a significant surplus this fiscal year. Revenue on a fiscal year basis remained almost constant for the three years from FY1976/77 to FY1978/79 while expenditure rose markedly over this period, resulting in deficits for the latter two years (See Table). The deficits inspired renewed reevaluation of government budgeting, contracting and procurement procedures that went beyond the anti-inflation efforts of the preceding years. The reforms instituted as a result of this reevaluation remain in force, even as revenues have mounted. Bids are more carefully scrutinized to insure realistic costing, large projects tend to be broken into smaller components to attract greater competition, new suppliers are encouraged to enter the market in order to maintain competitive pricing on government contracts.

Government accounts will return well into the black for FY79/80. Surpluses also seem unavoidable for the next several years. The spate of huge refinery and petrochemical projects now being signed, which will be financed primarily by the Saudi government (either through SABIC or the Public Investment Fund) should provide an outlet for part of the increasing revenue. While infrastructure will not be the government's primary focus during the coming several years, there are many major infrastructure projects which will continue to require increased funding. Maintenance and operation of facilities already constructed should absorb greater revenue than in the past, especially for such projects as hospitals, schools, military installations, and airports.

THE THIRD FIVE YEAR PLAN 1980-85

Government spending will remain the engine for substantial economic growth and development during the Third Plan (1980-85). The infrastructure put in place during the past five years has, for all practical purposes, eliminated the physical limits on the economy's absorptive capacity and soaring oil revenues (backed up by a huge government portfolio of foreign assets) have lifted financial constraints on development. However, this does not herald unbridled economic expansion. While the Saudi Government can be expected to set budgets at the levels required to promote its goals for national development, policymakers clearly perceive the potential social and political drawbacks of overly rapid modernization. Overall growth targets for the Plan will therefore synthesize desired economic development and the maintenance of the valued religious, cultural and social traditions of the Kingdom.

Within overall spending targets, Ministry of Planning officials have indicated that the new Plan will emphasize the development of social rather than physical infrastructure, concentrating on manpower training. The Minister of Planning has repeatedly emphasized the importance of training and the need to reduce reliance on foreign workers. Development of the "productive sectors" of industry and agriculture also rank high on the priority list. The next plan should also provide for greater decentralization both in terms of projects and in terms of greater provision of social services and infrastructure to outlying areas. The Jubail and Yanbu projects are perhaps the best examples of new poles of development outside the traditional Jidda-Riyadh-Dhahran axis. After the enormous buildup of facilities of all types during the Second Plan, an increased effort will be required during the Third Plan to maintain and operate these projects.

The Second Plan envisaged and, in fact, implemented bold initiatives in education, health, communications, transportation and construction. The focus for the Third Plan has been determined to a significant degree by that of its predecessor. The major refineries and petrochemical plants to be implemented as the lead projects in the campaign to industrialize are already signed or in the advanced stages of negotiation. In other areas, most Third Plan projects are much more likely to be logical continuations of lines drawn by the Second Plan than to go off in fundamentally new directions. This appears true for airports, schools, electricity generating facilities, desalination plants and port facilities, among others.

INFLATION

Saudi Arabia is one of the few countries which has recorded steadily decreasing inflation rates over the past five years. The non-oil GDP deflator, the best index of overall price trends in the economy, dropped from over forty percent in 1975/76 to less than ten percent during the latest reporting period, FY1978/79. This was accomplished through monetary restraint and by reducing bottlenecks, thereby increasing supplies of goods to the market. Monetary growth was brought under control by a combination of restrained government spending and tight control of local banks. However, since around forty percent of the supplies of goods and services in the economy are imported, it is difficult to avoid for long the consequences of rapidly rising prices abroad. During FY1978/79, the riyal was revalued 3.8 percent against the dollar, attenuating the domestic impact of import price increases. The riyal has remained stable vis-a-vis the dollar in FY1979/80 while overseas price increases have accelerated. Despite rising competition in the domestic economy and increased supplies, it is becoming steadily more difficult to insulate the Saudi economy from world price rises.

TRADE AND BALANCE OF PAYMENTS

Virtually all Saudi exports are comprised of crude oil, natural gas liquids, and petroleum products. As with the budget, the Government reported that 1978 external accounts (current account) moved from massive surplus to approximate balance as imports rose rapidly and exports slackened. The surge in oil price and production should once again push the current account well into the black for 1979 and result in an even more dramatic surplus in 1980. While imports of goods and services stand to rise substantially, they cannot match the jump in oil export earnings.

IMPLICATIONS FOR THE UNITED STATES

Saudi Arabia is likely to import over \$30 billion worth of goods as well as billions more in services this year. Unlike most markets, the main competition for U.S. suppliers is not from domestic manufacturers but from other exporters, mainly the Europeans and the Japanese. It is an open market which is the number one overseas customer for many major U.S. companies. Over 400 American firms have established themselves in the Kingdom.

Structural change in this oil-rich Mideast country is leading to less emphasis on the infrastructure and construction which was required to meet pressing demand for essential services following the 1973/74 oil price rises. Saudi Arabia is focusing greater attention on the following areas which offer some of the best opportunities for U.S. firms:

Petrochemical industry and crude oil refining.

Operation and maintenance of projects already completed or underway such as the following:

schools	hospitals	airports
ports	housing	industrial plants
aircraft		

Services - As incomes rise the population tends to consume a greater proportion of services such as the following:

- Medical and dental care
- Financial services
- Motor vehicle maintenance
- Building maintenance

Environmental protection and municipal sanitation.

Greater attention is also being paid to increased Saudi participation in joint ventures, especially in industry. Most joint ventures here were in the construction, construction materials, and light consumer goods sectors. There will be significant opportunities in Saudi Arabia for U.S. firms which are willing to move into industrial joint ventures in new sectors, especially those which will either provide products and services to the new petrochemical plants at Jubail and Yanbu or which will use the basic petrochemicals from these plants as a major input.

The Saudi Government has begun to break down large contracts into smaller segments with the intention of attracting a larger number of middle-sized Saudi and foreign firms to participate in development projects. The Saudi Government wants to encourage medium-size U.S. companies, not only the giants, to become active in the Kingdom.

In sum, this market has shifted from heavy emphasis on basic needs (housing, roads, communications) to become more sophisticated and increasingly service oriented. This does not mean that traditional U.S. markets in these countries for motor vehicles, construction equipment, food products, electrical goods, and machinery are declining. They have, in fact, shown healthy growth during the past several years. They are, however, likely to be replaced as the fastest growth sectors by the service-related and industrial joint venture areas.

CJCS

- ① tough; unprepared; good quality; no strategy
- ② debate would determine U.S./SA long - no good as it looks
- ③ FIS

CSA

- ① friendly, better by nature
- ② Long history
- ③ Saudi history - SA & the Pet n Jew - other arms were fags
- ④ SA would not be sweet
- ⑤ not here would deter for
- ⑥ M60 M1 → A1 - no more AF & more more - like 36 mil to start - V. large AD was R.F.S.W.
- ⑦ all well