

This post is part of an AGSIW series on Saudi Vision 2030, a sweeping set of programs and reforms adopted by the Saudi government to be implemented by 2030

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The Saudi budget for 2017 demonstrates that fiscal reform works; at least, it shows that with a reduction in spending will come a decline in deficit. The government aims to reduce the fiscal deficit to 7.7 percent of gross domestic product in 2017 from 11.7 percent in 2016. The act of budgeting and projecting spending and revenue is a central tenet of governance in Saudi Arabia, as in any other state. In Saudi Arabia, however, government spending drives most economic activity. The reining-in of government expenditure and the hopeful acceleration of private sector growth, the logic behind Saudi Arabia's Vision 2030 plan and National Transformation Program, both announced in mid-2016, will have a first full year's fiscal planning evaluation. Saudi governance and fiscal policy will be tested in 2017, with leaders and technocrats making difficult choices of how to spend oil revenue, the volatile and dominant source of government income, along with newer sources of capital, in international and local debt, and increased taxes and fees.

It also helps if the government's main source of revenue increases in price. The gradual rise of oil prices toward the end of 2016 has eased fiscal pressure, which may help the government sustain existing cuts to social spending (including public sector salaries) and utility subsidies while continuing to look for additional cost saving, including plans to cut as much as \$20 billion in existing government projects. Sustaining the reform momentum will be a balancing act between the perception of necessity in cost cutting, and the improved delivery of government services, from health care to security. At the least, Saudi Arabia is making very deliberate decisions about how to spend scarcer resources in 2017, in moves to maintain the difficult reforms put in place in 2016.

Reforms Holding Ground

There have been no announced plans for further subsidy cuts in 2017, though there are plans to introduce a "sin" tax on sugary drinks and tobacco in April, and a 5 percent value added tax should be introduced in early 2018. Government spending, on paper, is set to increase modestly in 2017, by approximately 6 percent according to Abu Dhabi Commercial Bank Chief Economist Monica Malik.

However, this increase may not reflect some tailwind spending in late 2016 in delivery of delayed government payments to contractors. In fact, Jadwa Investment, Emirates NBD, J.P. Morgan, and Abu Dhabi Commercial Bank all estimate that spending in the 2017 budget, projected at 890 billion Saudi Arabian riyals (over \$237 billion) will actually be flat or less than 2016 expenditure after accounting for late payments to contractors made at the end of 2016. So, the political forces for austerity and fiscal reform are holding their ground.

The ongoing efforts led by Saudi Arabia to decrease oil output from OPEC members continue, pushing the global price of oil higher. The 2017 budget is built on the expectation that oil revenue will increase to 480 billion Saudi Arabian riyals (nearly \$128 billion), from 329 billion Saudi Arabian riyals (around \$88 billion) in 2016. The inclusion of expected oil revenue within the 2017 budget is an unusual degree of transparency in the Saudi budget. If Saudi crude production sticks with the OPEC output agreement in the range of 10 million barrels per day, analysts see the budget projection including an assumption of oil prices around \$55 per barrel for 2017. Many other factors could disrupt this projection, creating greater pressure on Saudi Arabia to maintain its output cuts. What Saudi Arabia can't control in international energy markets it can try and control in its domestic economy.

Allocation across Ministries

In 2017, there will be more attention to how government expenditure is dispersed across ministries, and how the government intends to stimulate private sector growth. Allocations for 2017 are largely concentrated in defense and education. According to analysis by Emirates NBD, military expenditure combined with security and regional administration (as defined by the Saudi Ministry of Finance) will account for 288 billion Saudi Arabian riyals (nearly \$77 billion), or roughly a third of the total budget. There are likely other sources of defense expenditure, as there is not public data available for the source allocations or total costs of the Saudi military operations in Yemen, for example.

Special budget consideration for the National Transformation Program includes 42 billion Saudi Arabian riyals (about \$11 billion) in projects for 2017. How the government leverages its investment, especially in providing resources like affordable housing, in partnership with the private sector will be an essential early test of the new Saudi fiscal policy. Any privatizations that occur in 2017 might also be sources of new revenue, though the process of privatization and profit sharing will be equally important to the actual capital raised.



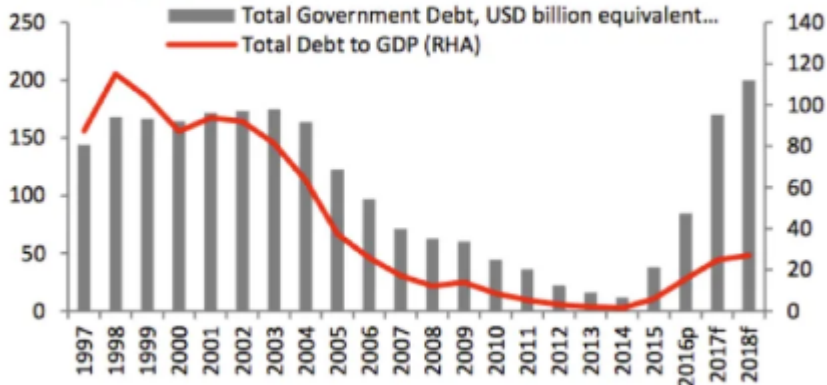
Source: Saudi Ministry of Finance, Emirates NBD Research

Financing the Deficit

Saudi Arabia is certain to run a deficit again in 2017, though the deficit is still low (as a percentage of GDP) compared to those of some of its neighbors, and certainly a lower debt to GDP ratio than many developed economies. According to Abu Dhabi Commercial Bank [research](#), Saudi government debt rose to 13.2 percent in 2016, more than doubling from the previous year, though not unprecedented in recent history. It was the anomaly of wealth generated by high oil prices in the last decade that made seeking external finance unnecessary for Saudi Arabia. Saudi Arabia may seek [more debt in 2017](#), reaching higher debt to GDP ratios very soon, but those shares of debt to GDP will still remain modest compared to [other G-20 economies](#).

Fig. 16. Government debt rises to 13.2% of GDP in 2016, up from 5.9% in 2015

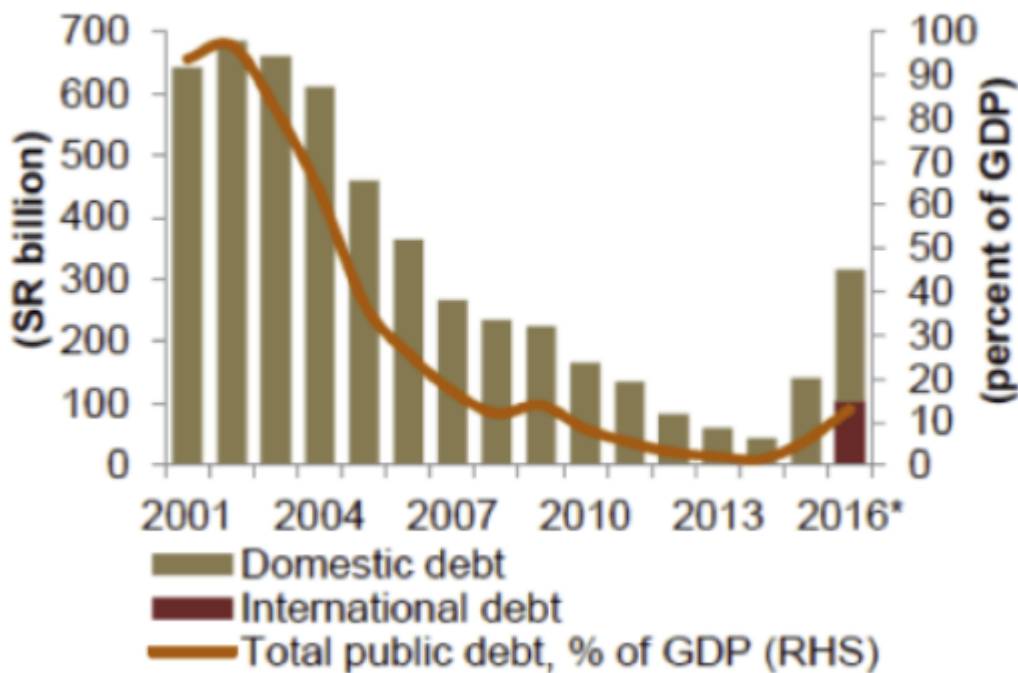
USD billion (LHA); % of GDP (RHA)



Source: SAMA, Budget Statements, ADCB estimates

It is also important to distinguish that Saudi Arabia's debt is outstanding more to local lenders than to international bond holders, raising questions about the impact on the domestic bank sector and private sector investors' ability to finance more government needs. As Jadwa [research](#) demonstrates, government debt issues to local lenders have been the traditional mechanism of fiscal deficit finance in Saudi Arabia's recent history.

Figure 14: Government debt



Note: * From the official budget statement.

Source: [Jadwa Investment](#)

However, the trouble with Saudi Arabia's [debt financing](#) has never been access to capital, but rather a clear government plan for revenue generation and economic growth that is diversified from oil exports that would make debt a path to economic transformation, rather than a pattern of fiscal planning. [Quips](#) that Saudi Arabia must move not to a post-oil but to a pre-oil era are apt in the necessity of the building blocks of a capitalist economy, a nascent private sector that the state might then seek to tax. Instead, the state is the foundation of the economy and most demand for goods and services links back to it. A reduction in the state's function as consumer cannot help but slow the Saudi economy down, at least in the short term.

New Sources of Revenue

The new economy envisions a more prominent role for private sector wealth generation and job creation. Historically, however, the state has driven the expansion of the Saudi economy. There is not

much of a tax base in the private sector, so any fiscal stimulus that targets private sector growth will not be easily recouped by the government in the form of corporate or income tax. As Steffen Hertog has [argued](#), the VAT plans will generate less revenue than new visa fees imposed on foreign workers. The government has imposed a [fee](#) of 100 Saudi Arabian riyals (almost \$27) per month per foreign worker in the commercial sector, while the undeveloped land tax will start generating government revenue in 2017. The International Monetary Fund [projections](#) of government revenue from the VAT estimate raising an annual 1.5 percent of GDP. Taxes and fees are an important, if still small, source of non-oil government revenue, but there are also cost-saving mechanisms in management of existing resources that are showing promise. According to Abu Dhabi Commercial Bank analysts, returns on investment holdings by the Saudi Arabian Monetary Authority, the central bank's assets, showed a [strong rise](#) in 2016, accounting for 31 percent of non-oil revenue in 2016, up from 21 percent in 2015.

Reforms across the GCC

Compared to its Gulf Cooperation Council neighbors, Saudi Arabia has perhaps fluctuated more in its stated budget expenditure over the last three years – as noted, the stated expenditure for 2017 is higher than 2016, but late payments to contractors and expenditures are not captured. Oman and Qatar, by proportion of spending, have had substantial reductions.

GCC Governments Expenditure (USD billions)			
Country	2015	2016	2017
Bahrain	9.56	9.77	
Qatar	62.69	61.78	
Oman	36.62	30.91	30.91
UAE	60	55.63	54.63
Saudi Arabia	268.68	226.65	244.65
UAE	13.49	13.34	13.34

Source: [Kingdom of Saudi Arabia Ministry of Finance](#); [Bahrain Ministry of Finance](#); [UAE Ministry of Finance](#); Reuters – [1](#), [2](#), [3](#), [4](#); PWC; NBK; Al Arabiya; Zawya

But in how governments allocate expenditure across ministries, there are consistent trends in prioritizing social spending, especially in health and education. Meanwhile, military and defense expenditure across the GCC is not diminishing in the age of fiscal reform. As a point of comparison, the United Arab Emirates 2017 budget, while not [expansive](#), continues to dedicate spending levels in health and social services. At the emirate level, there are more local efforts at fiscal governance as [Sharjah's 2017 budget](#) expands from 2016. The Sharjah budget includes substantial spending increases in national workforce investment and efforts to enhance infrastructure, which comprise 31 percent of the budget, to make the emirate's economic development prospects more competitive for private sector job and business growth. Culture and education spending account for roughly 20 percent of Sharjah's 2017 budget.

What these trends indicate is that *how* governments in the GCC choose to dedicate fiscal resources is becoming as important as *how much* they spend. Saudi Arabia's choices in fiscal governance will be tested in their ability to meet citizens' needs and in their foresight to generate economic growth, particularly in their creativity and efficiency in allocation.

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