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**Article**

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Financial Studies

**Provided in Cooperation with:**

"Victor Slăvescu" Centre for Financial and Monetary Research, National Institute of Economic Research (INCE), Romanian Academy

*Suggested Citation:* Naseem, Sana (2020) : Performance of fiscal measures in rectifying fiscal imbalances in Saudi Arabia, Financial Studies, ISSN 2066-6071, Romanian Academy, National Institute of Economic Research (INCE), "Victor Slăvescu" Centre for Financial and Monetary Research, Bucharest, Vol. 24, Iss. 4 (90), pp. 60-67

This Version is available at:

<https://hdl.handle.net/10419/231710>

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# PERFORMANCE OF FISCAL MEASURES IN RECTIFYING FISCAL IMBALANCES IN SAUDI ARABIA

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Sana NASEEM, PhD\*

## Abstract

This paper aims to assess the fiscal measures performance in Saudi Arabia initiated in 2016 and onwards in improving fiscal imbalances during the pre-reform period (2012-2015) and post-reform period (2016-2019). In this research, t-Test paired two samples for means has been used to determine the pre- and post-fiscal reform performance. The study finds that there is a significant difference in real gross domestic product, Debt-gross domestic product ratio and Central Government net financial assets over the two periods while fiscal deficit, current account deficit, oil prices and non-oil gross domestic product growth shows no significant difference over the two periods. Therefore, Saudi Arabian policymakers should take extensive steps to finance its budget deficit and should implement suitable policies that accelerate non-oil gross domestic product growth and meet the needs of citizens. The outcome of this research can be used in future research to perceive the impact of Vision 2030 on the Saudi economy.

**Keywords:** Fiscal Reforms, Fiscal Deficit, Oil Prices, Real-GDP Growth, Saudi Arabia.

**JEL Classification:** E62, H62, H63.

## 1. Introduction

Before 2014, Saudi Arabia had reaped the benefits of sustained periods of fiscal and external surpluses which help escalate macroeconomic stability. In 2014, the widening gap between the revenue and expenditures of the government caused a growing high

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fiscal deficit, i.e. -3.4% of GDP. The government's additional decline in net financial position increased borrowing from domestic and external sources, and a decline in oil prices severely worsened macroeconomic problems. This motivated the government to initiate several fiscal and economic reforms to accelerate the economic transformation and ensure sustainability by achieving economic growth and maintaining low-budget deficit ratios.

These issues together worsened international reliance on the Saudi economy. In response, Saudi Arabia launched Vision 2030 on 25<sup>th</sup> April 2016, which described a journey for a deep and ambitious socio-economic change in the kingdom and took several fiscal reforms aimed at accelerating economic transformation and ensuring fiscal sustainability through achieving economic growth and a narrow fiscal deficit. Thereafter, according to Fiscal Balance Program Report (2017), the National Transformation Program also announced, which commits to strengthening financial governance, increasing non-oil revenues and improving government spending on projects and programs. In late 2016, as a part of wider fiscal reforms like rationalization of government expenditure, restructuring government wages through revising the eligibility and feasibility of various allowances, reform in energy prices, initiative to increase non-oil revenues, and sustaining economic growth in the private sector, the Government commenced the fiscal balance program (FBP) with the main objective of achieving fiscal balance by 2020 (Fiscal Balance Program, 2017). The influence of these in inflating the non-oil revenue will continue to be seen in 2020 and the coming years.

This working research paper aims to assess fiscal reforms performance in Saudi Arabia initiated in 2016 and onwards in rectifying fiscal imbalances during the pre- and post-reform period. To assess these reforms performance, variables like Fiscal Deficit, Real GDP growth, Non-Oil GDP growth, Oil prices (US \$ Per Barrel), Debt GDP ratio, Central Government net financial assets (as a percent of GDP), and Current account balance (as a percent of GDP) have been selected by the researcher. Based on these variables, the researcher can assess the performance of fiscal measures.

## **2. Literature Review**

In this portion, studies focusing on the success of fiscal reforms in Saudi Arabia are briefly reviewed.

The implementation of Saudi Arabia's fiscal policy is undergoing significant changes, but reforms need to be further deepened and fiscal consolidation built into a framework that reduces the fiscal policy reliance on volatile oil revenues and makes medium-term fiscal objectives clearer. The important question is whether the introduction of a fiscal rule, as in some other resource-rich countries, will help with fiscal governance in Saudi Arabia (IMF, 2018a).

Algahtani (2016) examined the impact of oil price shocks on Saudi economic activity using annual data on all the oil price shocks from 1970 to 2015, particularly the fall in oil prices in the middle of 2014. To investigate the long-term and short-term relationships between variables, the vector autoregressive (VAR) and vector error-correction model (VECM) were used. The findings indicate a positive and important long-term relationship between oil prices and Saudi Arabia's GDP. Further, Young (2017) suggested that Saudi Arabia's fiscal governance choices will be tested based on its ability to meet the needs of citizens and generate economic growth, particularly its creativity and allocation efficiency.

An analysis by IMF (2015b) makes it clear that oil prices are key determinants of Saudi Arabia's macroeconomic outcome. Substantial fiscal buffer can be used in the near term to smooth out the impact of lower oil prices. Substantial fiscal buffer implies that there is no need for a knee-jerk reduction in fiscal spending; a medium-term fiscal consolidation plan and incremental changes are required. This will allow the government to continue focusing on key development priorities while reducing the medium-term fiscal risks that would build if spending does not adjust to lower oil prices over time.

IMF (2016) selected the "Issues" paper which discussed options for financing the government's fiscal deficit in Saudi Arabia. The Government of Saudi Arabia is working to develop a comprehensive strategy for meeting its budget financing needs. While external borrowing could alleviate domestic market pressures, it will also lead to new risks. Reliance on foreign investors may help to increase transparency.

IMF (2017) discusses Saudi Arabia's launch of a bold Vision 2030 reform agenda. The current reform momentum is strong and the reform implementation is making good progress. Under the OPEC+ agreement, Saudi Arabia has its cut oil production. Non-oil growth is expected to pick up this year, but the overall GDP growth will be close to zero given the decline in oil production. Growth is expected to

strengthen over the medium-term as structural reforms are implemented.

IMF (2018a) suggests that while the government should continue to work on a clear definition of its fiscal policy objectives, at this stage, the focus of the reforms should be to continue to strengthen the fiscal framework rather than introduce a formal fiscal rule. The fiscal law is just as strong as the institutions that support it. Moreover, the experience of resource-rich countries with fiscal rules has been varied, as it has proved difficult to formulate rules that are simple, flexible, and robust and that can withstand large fluctuations in commodity prices.

The IMF (2018b) paper discussed the momentum of reform remaining strong under Vision 2030. New reform initiatives are underway under the Vision Realization Programs (VRPs). Oil prices have risen over the past year and are having a positive impact on fiscal and external balances. However, higher oil prices are both an opportunity and a risk for fiscal reform.

The reforms discussed by the IMF (2019) have started to produce positive results. Oil prices and production have been volatile, and uncertainties remain in the global oil market. Promoting non-oil development and creating employment for Saudi people remain a key challenge.

### **3. Methodology**

Relevant data collected for this study are time series data and has been obtained from the Saudi Arabian Monetary Agency (SAMA) annual reports, and IMF country reports.

In order to assess the performance of the fiscal measures in Saudi Arabia initiated in 2016 and onwards in rectifying fiscal imbalances during the pre-reform period and post-reform period variables like Fiscal Deficit, Real GDP growth, Non-Oil GDP growth, Oil prices (US \$ Per Barrel), Debt GDP ratio, Central Government net financial assets (as a percent of GDP), and Current account balance (as a percent of GDP) have been selected by the researcher.

For dealing with these variables paper covers two periods: Pre reform period (2012-2015) and post reform period (2016-2019).

In this study, t-Test paired two samples for means has been used to check whether there is any significant difference in the value of selected variables between two periods.

The following are the hypothesis(s) of the study:

The null hypothesis (H0): *There is no significant difference in the selected value of variables between the two periods.*

The alternative hypothesis (H1): *There is a significant difference in the selected value of variables between the two periods.*

#### 4. Result and Discussion

Table 1

Results of Paired Samples t-Test

Variables	Mean		Std. Deviation		t-Test	sig. (2 tailed)
	Pre	Post	Pre	Post		
Fiscal Deficit	-0.35	-9.45	12.08	5.50	1.061	0.367
Oil Prices	90.2	48.02	27.16	4.35	2.88	0.063
Non-Oil GDP Growth	4.97	1.62	1.35	1.15	2.84	0.065
Real GDP Growth	3.97	1.27	1.12	1.33	5.24	0.013
Debt-GDP Ratio	3.13	18.10	1.87	4.12	-8.69	0.003
CGNFA*	40.96	4.43	3.83	10.41	10.43	0.002
Current Account Balance	10.40	3.45	13.76	5.73	0.759	0.503

\*Central Government Net Financial

Source: Author Compilation, Assets.

The result of the paired sample t-Test analysis revealed that the fiscal deficit has not changed significantly over the two periods. Since p-value (0.367) is more than 0.05 (5 percent), the null hypothesis is accepted. In 2012, the fiscal surplus in Saudi Arabia, it was found, reached 12%, which is reinforced by high oil prices and oil revenues to the government budget (Fiscal Balance Program Report, 2017). However, between 2014 and 2016, oil prices dropped significantly and in 2015, the Saudi government revealed the highest deficit in its budget. The Saudi government implemented a few fiscal consolidation measures, such as VAT, excises, dependent fees, and energy & water price reform to reduce the fiscal burden on the government. The impact of these measures narrowed the fiscal deficit from 17.2% of the GDP in 2016 to 4.7% of the GDP in 2019.

There is no significant difference in oil prices over the two periods, as shown in Table 1. Since the p-value (0.063) is more than 0.05, the null hypothesis is accepted. It is found that the mean of oil prices pre-reform was higher i.e 90.22\$ per barrel in comparison to post-reform periods i.e 48.02\$ per barrel. During 2012-13, high oil

prices and increased oil production resulted in a large increase in oil revenue and fiscal surplus while declining the Government debt to 3.5% of the GDP. According to the IMF Report (2015a), in 2014, the global oil market environment changed substantially with nearly a 50% drop in oil prices. This is partly due to decline in demand, but more importantly by supply factors. Since the mid of 2017, the moderate rise in oil prices has alleviated fiscal pressure and has increased the importance of structural reforms to transfer the focus from the growth of the public sector growth to the growth of the private sector.

The mean value of real GDP in the pre-reform period is more than the mean value in the post-reform period. As per the result of the paired t-test, the p-value (0.013) is less than 0.05. Therefore, an alternative hypothesis is accepted. Real GDP growth was vigorous during 2012-15 but relatively slow compared to the growth seen in 2011-12 due to a decline in oil production and public sector GDP growth. It is found that real GDP growth recovered to 2.2% in 2018 after contracting in 2017 (-0.07) and is expected to recover more in the coming years.

The analysis of non-oil real GDP shows that there is no significant difference in real non-oil GDP growth over the two periods. The calculated result in Table 1 reveals that the p-value (0.065) is more than 0.05, therefore, the null hypothesis is accepted. The mean value of non-oil GDP growth in the pre-reform is greater than the mean value in the post-reform period. According to IMF Staff estimation (2017), the rate of non-oil GDP growth has slowed, and it nearly reached zero in 2016 which opened up an output gap of -3.4, since the fall in oil prices in 2014. It is found that real non-oil GDP growth ascended from 2.1% in 2018 to 2.9 % in 2019 without being affected by higher electricity prices, dependent tax and levied VAT. It is anticipated that this growth will continue to rise in the coming years since raising non-oil GDP growth is one of the key objectives of Vision 2030.

The analysis of the debt-GDP ratio indicates that the debt-GDP ratio in the post-reform period ( $m = 18.1$ ) is greater than the pre-reform period ( $m = 3.13$ ). Since the p-value (0.003) is less than 0.05, an alternative hypothesis is accepted. There has been a continuous rise in the debt-GDP ratio during the post-reform period and is expected to increase further in the coming years. However, Saudi Arabia still has the lowest world debt.

The analysis of the CGNFA reveals that there is a significant difference in CGNFA over the two periods, as shown in Table 1. Since

the p-value (0.002) is less than 0.05, an alternative hypothesis is accepted. The mean value of CGNFA in the pre-reform period is more than that of the post-reform period. This indicates that during 2016-19, the net financial asset position of the government deteriorated due to the continuous increase in gross debt (Percent of GDP) and a decline in central government deposits at SAMA.

The calculated result in Table 1 reveals that the p-value (0.503) is greater than 0.05, therefore the null hypothesis is accepted. The mean value of the current account balance during 2012-2015 (pre-reform), is greater than that of 2016-2019 (post-reform). This indicates that the current balance as a percent of GDP before the reforms was higher in comparison to the post reforms period. According to the IMF Report (2019), the current account balance is projected to narrow from 9.2% of GDP in 2018 to 6.9% of GDP in 2019 as oil export revenues moderate and import growth increases.

## **5. Conclusion**

For assessment of fiscal measures, the variables such as fiscal deficit, real GDP growth, non-oil GDP growth, oil prices, debt GDP ratio, central government net financial asset, and current account balance have been observed. The study has considered the two periods: Pre reform period and post reform period. This study shows a significant difference in real GDP growth, Debt-GDP ratio and Central Government net financial assets over the two periods. It shows that there has been an effective influence of fiscal reforms on real-GDP growth. There has been a decline in net financial asset position of the government during post reform period due to the continual increase in gross debt (Percent of GDP). However, Saudi Arabia still has the lowest world debt. The study shows that fiscal deficit has not changed substantially due to the fall in oil prices. The analysis indicates that the balance of the current account has declined due to a decline in net exports. The study shows that pre-reform growth of non-oil GDP was higher than post-reform growth. To conclude, this study is restricted to only eight years.

However, reforms in the kingdom are a long and complicated path. These reforms would enable the Kingdom to stimulate non-oil GDP growth and, in the long run, to improve its fiscal position. Nonetheless, global oil price volatility will pose a risk of instability in the region. Hence, Saudi Arabian policymakers should take extensive



steps to finance its budget deficit and should implement suitable policies that accelerate non-oil gross domestic product growth and meet the needs of citizens. The outcome of this research can be used in future research to perceive the impact of Vision 2030 on the Saudi economy.

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